

HEARING

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

Arizona Corporation Commission

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ARIZONA CORPORATION COMMISSION
HEARING DIVISION

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DOCKET NO. E-00000A-02-0051

IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING ELECTRIC
RESTRUCTURING ISSUES.

DOCKET NO. E-01345A-01-0822

IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR
VARIANCE OF CERTAIN REQUIREMENTS OF
A.A.C. R14-2-1606.

DOCKET NO. E-00000A-01-0630

IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING THE ARIZONA
INDEPENDENT SCHEDULING
ADMINISTRATOR.

DOCKET NO. E-01933A-02-0069

IN THE MATTER OF TUCSON ELECTRIC
POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
COMPETITION RULES COMPLIANCE DATES.

DECISION NO. **65743**

OPINION AND ORDER

DATES OF HEARING:

November 20, (pre-hearing) 21, 22, 25, 26 and 27, 2002

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Teena Wolfe

IN ATTENDANCE:

William A. Mundell, Chairman
Marc Spitzer, Commissioner
Jim Irvin, Commissioner

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10 Arizona Utility Investors Association;

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13 behalf of the Harquahala Generating Company;

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19 Sundance Energy, LLC.;

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22 behalf of the Utilities Division of the Arizona
23 Corporation Commission.
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BY THE COMMISSION:**I. INTRODUCTION****A. Procedural Background**

Following a Special Open Meeting held on April 25, 2002, the Commission issued a Procedural Order in these consolidated dockets on May 2, 2002. The May 2, 2002 Procedural Order set a hearing schedule for those issues delineated as "Track A" issues, and established a preliminary procedural framework for meeting an October 21, 2002 completion date for Commission consideration of competitive solicitation issues, which were delineated as "Track B" issues. The May 2, 2002 Procedural Order directed that Track B proceed concurrently with Track A, and instructed interested parties to file by May 13, 2002, a list of proposed issues for consideration, and a procedural timetable (including comment periods) for the Track B issues. The May 2, 2002 Procedural Order also ordered the parties to submit to the Commission's Utilities Division Staff ("Staff") a list of qualified persons to act as an independent consultant/evaluator, and ordered Staff to begin any required procurement process as soon as possible. The May 2, 2002 Procedural Order directed Staff and the parties to keep the Commission and the Hearing Division apprised of the progress being made on Track B through docket filings, and to immediately contact the Hearing Division if additional issues required resolution.

On May 13, 2002, Tucson Electric Power Company ("TEP"), Arizona Public Service Company ("APS"), the Arizona Competitive Power Alliance ("Alliance"), the Residential Utility Consumer Office ("RUCO") and Staff filed Track B proposals in compliance with the May 2, 2002 Procedural Order. Staff indicated in its filing that it anticipated awarding a contract to an Independent Evaluator on or around July 8, 2002.

On May 31, 2002, Staff filed a list of issues for comment of the other parties. On June 20, 2002, based on the proposals submitted on May 13, 2002, the First Procedural Order on Track B Issues established a procedural schedule that included workshops, as proposed by Staff, on July 24 and 25, 2002. The First Procedural Order stated that the balance of the procedural schedule would be dependent upon the Commission's Decision on the Track A issues, the consensus reached by the parties during the workshops or otherwise, and whether a hearing on any Track B issues became

1 necessary. The First Procedural Order set a deadline for the parties to respond to Staff's May 31,
 2 2002 list of issues by July 1, 2002, which response was to include any competitive solicitation issues
 3 not addressed in Staff's May 31, 2002 filing, and also set a deadline of July 17, 2002, for Staff and
 4 the Independent Evaluator to file a list of issues to be addressed at the July 24 and 25, 2002
 5 workshops. In addition, the First Procedural Order encouraged the parties to meet and attempt to
 6 achieve a consensus competitive solicitation proposal as outlined by APS in its May 13, 2002 filing,
 7 and directed Staff to continue preparation for the filing of a Draft Staff Report by the August 28,
 8 2002 deadline referred to in its May 13, 2002 filing, pending the issuance of a further procedural
 9 schedule.

10 Hearings were held on the Track A issues during the last two weeks of June, 2002, and
 11 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its
 12 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in
 13 Track B to develop a competitive solicitation process¹ that can begin by March 1, 2003.

14 The parties held an additional workshop on August 13 and 14, 2002.

15 On September 16, 2002, Staff filed a Request for Procedural Order ("Request") asking that a
 16 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to
 17 be held on September 26 and 27, 2002. APS and Panda Gila River, L.P. ("PGR") filed responses to
 18 Staff's request indicating their agreement that a hearing would likely be necessary to achieve a
 19 resolution of the Track B issues. While APS agreed with the procedural schedule proposed by Staff
 20 in its Request, PGR requested a scheduling conference so that all parties might comment on dates to
 21 be included in any procedural order and on issues to be addressed at the hearing. The Second
 22 Procedural Order on Track B Issues was issued on September 24, 2002 and required the parties to
 23 file, by October 1, 2002, their proposed schedules for the conduct of a hearing to be held following
 24 the third workshop, and a list of the specific issues the parties believed remained to be addressed at
 25 the hearing. A Procedural Conference was held as scheduled on October 2, 2002. It became known

26
 27 ¹ Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and TEP shall acquire, at
 28 a minimum, any required power that cannot be produced from their respective existing assets, though the competitive
 procurement process as developed in the Track B proceeding; and that the minimum amount of power, the timing, and the
 form of procurement shall be determined in the Track B proceeding.

1 at the October 2, 2002 Procedural Conference that the existing Track B schedule being discussed in
 2 the workshops did not require APS and TEP to provide their needs assessments and procurement
 3 proposals until January 31, 2003, which was after the hearing dates being proposed by the parties.
 4 The Third Procedural Order on Track B Issues, issued on October 9, 2002, therefore required that
 5 APS and TEP file a needs assessment and procurement proposal, sufficient to inform the Commission
 6 in its determination of the minimum amount of power, the timing, and the form of procurement as
 7 required by Decision No. 65154 (“Needs Assessment”), along with supporting testimony, by
 8 November 4, 2002, in order to allow the other parties to respond in their pre-filed direct testimony.
 9 The Third Procedural Order also set the remainder of the procedural schedule for the hearing, and for
 10 the pre-filing of direct and rebuttal testimony and exhibits.

11 On October 25, 2002, Staff filed its Staff Report on the Track B Issues. The Staff Report
 12 contained a “Detailed Staff Proposed Solicitation Process” and also included a separate section
 13 setting forth Staff’s position on unresolved issues. On November 4, 2002, APS and TEP filed their
 14 Needs Assessments pursuant to the requirements of the Third Procedural Order. Following the
 15 November 4, 2002 filings, the parties held an additional workshop on November 6, 2002.

16 On November 12, 2002, APS and TEP filed their direct testimony, including their response to
 17 the Staff Report. Also on November 12, 2002, Harquahala Generating Company, L.L.C.
 18 (“Harquahala”), PGR, Reliant Resources, Inc. (“Reliant”), Sempra Energy Resources (“Sempra”),
 19 Wellton-Mohawk Generating Facility (“WMGF”), the Land and Water Fund of the Rockies (“LAW
 20 Fund”) and RUCO filed their direct testimony and exhibits, including their responses to the Staff
 21 Report and to APS’ and TEP’s Needs Assessments. On November 18, 2002, APS, TEP, Harquahala,
 22 PGR, Reliant, Sempra, WMGF, the LAW Fund, RUCO and Staff filed rebuttal testimony and
 23 exhibits.

24 Public notice of the proceedings on the Track B issues was published in the *Arizona Daily*
 25 *Star* on November 4, 2002, and in newspapers of general circulation across APS’ service territory² on
 26 either November 5 or 6, 2002. No further intervention requests were filed following the publication.

27 ² The newspapers in which publication occurred were *Arizona Republic*, *Bisbee Daily Review*, *Douglas Daily*
 28 *Dispatch*, *Flagstaff AZ Daily Sun*, *Holbrook Tribune*, *Parker Pioneer*, *Payson Roundup*, *Prescott Daily Courier*, *Sedona*
Red Rock News, *Tri Valley Dispatch*, *Wickenburg Sun*, *Winslow Mail* and *Yuma Daily Sun*.

1 The hearing commenced on November 21, 2002. Mr. Bob Liden of Stirling Energy Systems
 2 provided public comment at the hearing, encouraging the Commission to make sure that renewables
 3 are included in the bidding process, are given some preferences in the bidding process, and that
 4 power purchase agreements for renewable energy are made for long terms in order to support the
 5 capitalization of such plants. No other parties appeared to provide public comment on the Track B
 6 issues. Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra, WMGF, the LAW Fund and RUCO
 7 appeared through counsel and presented their witnesses. Other parties participating in the hearing
 8 included the Arizona Utility Investors Association (“AUIA”) and PPL Southwest Generating
 9 Holdings, LLC, PPL Energy Plus, LLC and PPL Sundance Energy, LLC (“PPL”) and Southwestern
 10 Power Group II (“SWPG”).

11 Staff, APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW
 12 Fund, and RUCO filed initial post-hearing briefs on December 18, 2002. APS, TEP, Harquahala,
 13 PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund, RUCO and Staff filed reply briefs on
 14 December 31, 2002.

15 **B. Goals of the Staff Proposed Solicitation Process**

16 The Staff Report, filed on October 25, 2002, included a Detailed Staff Proposed Solicitation
 17 Process and Solicitation Timelines. (Exh. S-1 at 6-29). A copy of that section of the Staff Report is
 18 attached hereto as Exhibit A. During the workshop process, Staff developed a draft working paper
 19 regarding the competitive solicitation process and parties were able to provide substantive comment
 20 and make suggestions to Staff on the draft solicitation process. (*Id.* at 3) The numerous participants
 21 in the workshops, not all of whom participated in the hearing process, are listed in the Staff Report at
 22 pages 2-3.

24 Staff has stated that its overriding goal in this process is to establish a transparent process that
 25 will result in cost savings for ratepayers, and that this goal should be used as a standard to evaluate
 26 every disputed issue in this proceeding. PGR agreed, stating it believes that the only way to fully
 27 explore and establish potential ratepayer cost savings is to solicit, from the competitive market,
 28

1 alternatives to “current ratepayer cost items.” PPL also believes that the competitive solicitation must
2 be open, transparent, fair and unbiased as to all participants, and structured so as to best achieve the
3 best value for ratepayers. Sempra and SWPG strongly support the competitive process procurement
4 goals set forth in the Staff Report, and believe that the Commission should adopt a competitive
5 procurement process that allows for consideration of all types of competitive solicitations and
6 proposals; requires sound economic and deliverability analysis of bids; and is not biased by nature
7 and design towards any predetermined outcome.
8

9 As RUCO points out, the parties are nearly unanimous in their agreement that the goal of
10 competitive power solicitation should be a least-cost mix of reliable power to customers. RUCO
11 believes that the competitive power solicitation should yield cost savings for customers compared to
12 what they pay today and what they expect to pay in the future, and believes that the Commission can
13 meet these goals if the solicitation gives standard offer customers a least-cost portfolio of reliable
14 electricity services.
15

16 APS also endorsed the general goals of Staff in carrying out the Track B process, and supports
17 an effective power procurement process for consumers.

18 **C. Issues Requiring Resolution**

19 The issues on which the parties were unable to reach consensus, and thus require a
20 Commission resolution, are as follows: 1) the solicitation and bid process to be approved,
21 including whether to institute an integrated resource planning process; 2) the amount of capacity and
22 energy to be solicited; 3) the bid evaluation method to be approved, including whether APS and TEP
23 are required to accept any bids; 4) affiliate participation in the bid process; 5) the Commission’s
24 prudence review of contracts resulting from the bid process; and 6) the direction of future
25 proceedings, including DSM and environmental risk mitigation programs.
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II. PARAMETERS OF THE SOLICITATION**A. Decision No. 65154's Track B Requirements**

Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and TEP shall acquire, at a minimum, any required power that cannot be produced from their respective existing assets, through the competitive procurement process as developed in the Track B proceeding; and that the minimum amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding. Decision No. 65154 stated that the overriding concern of the Commission must continue to be ensuring that the citizens of Arizona have safe, reliable and fairly priced electric power, and found that it is incumbent upon all parties to work together in such a manner that will allow competition and its expected benefits to develop in whatever timeframe is needed to make it successful, while satisfying that concern. In Decision No. 65154, the Commission stated its belief that requiring some power to be purchased through the competitive procurement process will encourage a phase-in to competition, encourage the development of a robust market for wholesale generation, and obtain some of the benefits of the new Arizona generation resources, while at the same time protecting ratepayers.

Decision No. 65154 required that for purposes of the competitive solicitation process, the generating assets that APS may seek to acquire from its affiliate, PWEC, shall not be counted as APS assets in determining the amount, timing and manner of the competitive solicitation. Also pertinent to Track B, Decision No. 65154 ordered TEP and APS to work with Staff to develop a plan to resolve reliability must-run generation ("RMR") concerns, and ordered Staff to include the results of such a plan in the 2004 Biennial Transmission Assessment ("BTA"). Decision No. 65154 ordered APS and TEP to file annual reliability must-run generation study reports with the Commission in concert with their January 31 ten year plan, for review prior to implementing any new RMR generation strategies, until the 2004 BTA is issued.

1. Parties' Interpretations of Decision No. 65154**a. "Minimum amount of power"**

In Decision No. 65154, the Commission ordered "that upon implementation of the outcome of Track B, APS [and TEP] shall acquire, at a minimum, any required power that cannot be produced from its own existing assets, through the competitive procurement process as developed in the Track B proceeding. The minimum amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding." (Decision No. 65154 at 33) Decision No. 65154 expounded on the phrase "at a minimum," stating that "APS and TEP may decide to retire or displace inefficient, uneconomic, environmentally undesirable plants." (Decision No. 65154 at 23, fn. 8) Decision No. 65154 thus set the minimum baseline amount of power that APS and TEP would be required to acquire in the solicitation process. Decision No. 65154 left for this proceeding, however, the determination of the actual minimum amount of power to be acquired, the timing of the power procurement, and the form of the procurement. (Decision No. 65154 at 33)

The parties are not in agreement as to the interpretation of Decision No. 65154 regarding the amount of power that APS and TEP must solicit in the Track B procurement process. APS takes the position that it should not be required to solicit supply beyond that which its own resources and firm contracts cannot provide. APS defines this supply as its "unmet needs," and believes its calculations of unmet needs, as set forth in its November 4, 2002, Needs Assessment filing, are in "strict conformance" with Decision No. 65154. TEP takes a similar position, stating that its contestable load for the initial competitive solicitation should include only TEP's capacity and energy needs that cannot be met by its existing assets. AUIA similarly argues that the utilities should not be required to solicit any generation beyond any required power that cannot be produced from their own existing assets, unless the utilities decide to retire some generating plants.

...

Staff and the merchant intervenors disagree with the interpretation that APS, TEP and AUIA lend to Decision No. 65154's language regarding the minimum amount of power that APS and TEP must acquire. PGR argues, and Reliant agrees, that the Commission reference to "at a minimum" in Decision No. 65154 is modifying what APS and TEP are required to acquire, and not the amount that will be sent out for solicitation. Staff asserts that this proceeding is concerned with determining contestable load amounts, rather than establishing unmet needs.³

b. "Economically"

Staff, in its pre-filed rebuttal testimony, proposed a modification to the language in the Staff Report pertaining to the amount of capacity or energy that APS and TEP must acquire through competitive solicitation. (Exh. S-4 at 11-12 (Rebuttal Testimony of Alan Kessler)) Staff proposed to insert the word "economically" on page 4, line 20 of the Staff Report before the word "served."⁴ Staff proposed this change in response to APS' November 4, 2002 Needs Assessment, in which APS proposed to procure a large portion of its required energy on the spot market, outside of the Track B competitive solicitation process.⁵ Staff explained that it proposed this change to clarify that, during the development of the solicitation process, Staff's intention was to have the vast majority of reasonably expected purchases of capacity and energy acquired through the initial solicitation process Staff proposed. (*Id.* at 12) Staff believes the anticipated amount of "economy energy" APS

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³ Staff explains that "unmet needs" describes the capacity and energy that the utility is not able to supply from its own facilities, and that "contestable load" describes the amount of capacity and energy for which a competitive alternative may be available. TEP similarly states that "unmet needs" connote those capacity and energy needs that simply cannot be met by the utility's existing assets, and that "contestable load" connotes the amount of capacity and energy that must be put out to bid in the solicitation process.

⁴ During the hearing, Staff confirmed that in accordance with this change, the word "economically" should also be inserted in the Staff Report at page 6, line 5, before the word "served" and at page 35, line 5, before the word "supply."

⁵ APS stated that these purchases would be "economy energy" purchases. This issue is discussed in a separate section below.

1 identified in its Needs Assessment should be solicited on a firm or dispatchable basis, and then
2 evaluated by the utility based on the information it will acquire as a result of the solicitation, to
3 determine whether contracts for power are better alternatives than reliance on spot markets. (*Id.*)
4 Staff emphasized that the utility should remain responsible for making, and justifying its decisions
5 when evaluating bids. (*Id.*)

6 APS argues that a requirement that it acquire, through competitive solicitation, needs not
7 “economically” served by existing utility-owned generating capacity or through existing contracts is
8 contrary to specific language in Decision No. 65154 and would subject APS to financial risk. AUIA
9 argues that insertion of the term “economically” in the parameters of the competitive solicitation
10 would dramatically alter the amount of utility load that could be subject to bid under the terms of
11 Decision No. 65154. TEP is also concerned that such an approach may subject the entire load of a
12 utility to competitive solicitation, and believes that it will complicate the process and interfere with
13 an assessment of how a competitive solicitation may best be conducted in the future.

14
15 Harquahala, PPL, PGR, Reliant, Sempra and SWPG support the use of the term
16 “economically” as recommended by Staff. Harquahala believes the term “economically” should
17 apply to both capacity and energy procurements, and is of the opinion that imposing an “economic”
18 criteria for the solicitation will promote fiscally responsible choices, not financial risks. Sempra and
19 SWPG believe inclusion of the term “economically” is consistent with the Commission’s stated
20 objective, in Decision No. 65154, of insuring just and reasonable rates for captive customers. PPL
21 states that the concept is consistent with the goal of reduced costs to customers, and that allowing
22 efficient new generation units to compete against less efficient units should result in consumer
23 savings with less environmental impact. Staff asserts that to construe Decision No. 65154 as omitting
24 considerations of cost when determining contestable load is logically inconsistent with the
25 Commission’s goal of providing ratepayers with reliable power at the lowest possible cost.
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2. Discussion/Resolution

We do not believe requiring APS and TEP to solicit, through competitive solicitation, needs not economically served by existing utility-owned generating capacity or through existing contracts, is contrary to Decision No. 65154. In their arguments that Decision No. 65154 limits the competitive solicitation to “unmet needs,” APS, TEP and AUIA offer no convincing reason for us to disregard our prior statements that “the minimum amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding” (Decision No. 65154 at 33), and that “APS and TEP may decide to “retire or displace inefficient, uneconomic, environmentally undesirable plants.” (Decision No. 65154 at 23, fn 8, emphasis added) Decision No. 65154 does not limit the Commission in the amount of power we may require APS and TEP to solicit in the competitive procurement process. At a minimum, as we stated in Decision No. 65154, APS and TEP must acquire, through this competitive solicitation, any required power that cannot be produced from their respective existing assets.⁶ Nothing in this Decision changes that requirement.

The Commission’s purpose in establishing this Track B proceeding was not to determine APS’ and TEP’s “unmet needs,” but to determine the actual amount of power to be solicited in the competitive solicitation, which necessarily will include, but will not be limited to, their required power that cannot be produced from their respective existing assets. Based on the record in this proceeding, we believe that it is in the best interest of APS’ and TEP’s ratepayers for APS and TEP to test the market in this solicitation, beyond the amount of required power that cannot be produced

⁶ Staff’s updated version of Exh. S-5, discussed further below, is attached hereto as Exhibit B. Exhibit B includes the most recent estimates available of APS’ and TEP’s required power that cannot be produced from their own existing assets, as follows:

For APS, 1,661 MW of capacity and 639 GWH of energy for 2003; 1,935 MW of capacity and 840 GWH of energy for 2004; 2,055 MW of capacity and 1,228 GWH of energy for 2005; and 2,151 MW of capacity and 1,469 GWH of energy for 2006.

For TEP, 50 GWH of energy for 2003; 46 GWH of energy for 2004; 120 GWH of energy for 2005; and 104 GWH of energy for 2006.

Staff states that these numbers are subject to adjustment in the Pre-Solicitation process set forth in the Staff Report at pages 12-22, which pages are included in the attached Exhibit A.

1 from their respective existing assets or existing contracts, which will allow APS and TEP to evaluate
2 whether reliable generation is available at a lower cost than that produced by their own existing
3 assets, or at a comparable level of cost, but with reduced adverse air quality and water issues effects,
4 compared to their own existing assets. A broader solicitation will also further the goal of
5 encouraging the development of a robustly competitive wholesale generation market in Arizona. The
6 amount by which APS and TEP must test the market in this competitive solicitation, and which will
7 include their required power that cannot be produced from their respective existing assets or existing
8 contracts, will be referred to herein as “contestable load.” We will require that the initial competitive
9 solicitation be issued for the amount of APS’ and TEP’s contestable load, as set forth in this
10 Decision, and that it not be limited to required power that cannot be produced from their respective
11 existing assets or existing contracts. While this record has not developed sufficiently quantitative
12 evaluation criteria for measuring and weighing environmental impacts, we are cognizant of the
13 incontrovertible fact that natural gas-fired, combined cycle, combustion turbine generation emits far
14 fewer pollutants than oil-fired or coal-fired generation. That said, it is also true that “location
15 matters,” and relatively higher polluting generation far from highly populated airsheds may be
16 preferable to a natural gas-fired, combined cycle, combustion turbine plant in a highly populated
17 airshed. These contradictions make it impossible for us to set a firm benchmark in this Order.
18 Therefore, we will require the utilities to prepare an environmental analysis for this Commission and
19 submit it to this docket within 90 days of completion of the solicitation. That analysis will detail the
20 environmental effects of the utilities’ power supply portfolio resulting from this solicitation against a
21 benchmark analysis of the environmental impacts of the utilities’ past five years of operations.
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25 If the competitive solicitation for contestable load yields bids for capacity or energy beyond
26 required power that cannot be produced from their respective existing assets or existing contracts, and
27 if the utilities determine, after serious economic and technical analysis, that the offered capacity or
28

1 energy would serve their customers more economically than their existing assets, then the utilities
2 should make procurements accordingly, keeping in mind that the goal of the competitive solicitation
3 is to provide ratepayers with reliable power at the lowest cost while furthering the Commission's goal
4 of encouraging the development of a vibrant wholesale generation market in Arizona. To resolve our
5 inability to properly assess and weigh environmental factors as noted above and to ensure that future
6 competitive solicitations are able to accurately and reliably assess the environmental impacts of
7 solicitation decisions, we direct Staff to begin a series of environmental risk management workshops,
8 commencing in the summer, in which Staff and the parties shall develop a set of criteria that are
9 knowable and measurable and which can be used in future solicitations to weigh the environmental
10 impact of offers received in the solicitation process.
11

12 In regard to the APS claim that expanding the solicitation beyond required power that cannot
13 be produced from its existing assets or contracts would subject APS to financial risk, we note that
14 since APS will make the decision as to how much competitive power to procure, beyond its
15 requirements that cannot be produced from its own existing assets or contracts, any financial impact
16 of such procurement is within APS' control. This Order is not intended to change the current rate
17 base status of any such existing assets.
18

19 **B. Capacity and Energy to be Solicited (Contestable Load)**

20 **1. Determination of Contestable Load Estimates**

21 **a. Positions of the Parties**

22 APS and TEP took the position that contestable load (as defined herein, above) should consist
23 only of required power that cannot be produced from their respective existing assets or existing
24 contracts. In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule
25 PME-1, attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B
26 solicitation. Staff and the merchant intervenors took the position that contestable load for the initial
27
28

1 solicitation should include more capacity and energy than APS' and TEP's estimates of required
 2 power that cannot be produced from their respective existing assets or existing contracts, as
 3 represented in their respective Needs Assessments.

4 The Staff Report included a table that provided estimated contestable loads for APS and TEP
 5 for the years 2003, 2004, 2005 and 2006, broken down into capacity and energy. (Exh. S-1 at 7)
 6 Staff states that it used the capacity requirement and average system capacity factor information
 7 provided by the utilities to develop its estimates, which are not precise. (Exh. S-3 at 7 (Rebuttal
 8 Testimony of Alan Kessler)) Staff explained that under its approach, contestable load and energy
 9 would be adjusted during the Pre-Solicitation phase of the solicitation process (*see* Exh. S-1 at 12-16)
 10 to accommodate changes in projected load and system economics, with final quantification to occur
 11 prior to the issuance of the initial solicitation. (Exh. S-3 at 7) At the hearing, Staff presented its
 12 Revised Contestable Loads Estimate, Exh. S-5, which is an updated version of the Staff Report
 13 estimates.⁷ A significant portion of the increase in Staff's APS energy estimates from those in the
 14 Staff Report results from the addition of "economy purchase" amounts. Those "economy purchase"
 15 amounts are identical to the "economy energy" amounts appearing in Schedule PME-13 to APS'
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 24 ⁷ The Staff Report states that the table appearing at page 7 of Exh. S-1 (the Staff Report) was based on capacity
 25 numbers, provided by APS at the August workshop, which Staff also used to derive the energy numbers. APS provided
 26 revised capacity and energy numbers to Staff on October 23, 2002. Because there was not sufficient time for Staff to
 27 review and analyze the revised information for inclusion in the Staff Report by the October 25, 2002 filing date, Staff
 28 attached the revised APS information as Appendix Two to the Staff Report. At the hearing, Staff presented hearing Exh.
 S-5 as a replacement for the table appearing on page 7 of Exh. S-1. Staff's witness stated that APS supplied all the parties
 with additional new information at a November 6, 2002 workshop, that more additional information was received a few
 days prior to the hearing, and that the new information was incorporated into Staff's preparation of Exh. S-5. (Tr. at 51-
 52)

Needs Assessment, Exh. APS-1. Staff subsequently attached an updated version of hearing Exh. S-5 as Exhibit A to its Initial Closing Brief filed on December 18, 2002.⁸ A copy is attached hereto as Exhibit B.

PGR supported the numbers in Exh. S-5 as the minimum solicitation of capacity that should be required. However, PGR believes that in order to be consistent with APS' prior positions in these consolidated dockets, that a higher number for solicitation of energy is appropriate for APS, and that the Commission should instead adopt the higher solicitation volumes contained in Exh. S-1, the Staff Report. As justification for Commission adoption of the higher contestable load for APS, PGR points to APS' stated plans at the August workshop, prior to Decision No. 65154, to displace 5,728 gigawatt hours ("GWH") of energy from its own generation with long-term procurement of energy from its affiliate Pinnacle West Energy Corporation's ("PWEC") new combined cycle gas fired units in 2003. (*See* Schedule PME-3R to Exh. APS-4 (Ewen Rebuttal Testimony)) Harquahala also reasons that the discrepancy between APS' earlier plans to procure energy and capacity from its affiliate PWEC, and the current plans to purchase comparable amounts of energy on the spot market, as revealed in APS' Schedules PME-1 and PME-13 attached to its Needs Assessment, lends greater

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⁸ This most recent of Staff's contestable load estimates incorporates the elimination, discussed at the hearing, of 215 MW from Staff's energy estimates for APS. For Staff's TEP estimates, the updated version of S-5 includes the addition of previously unavailable local RMR generation estimates, and the addition of "economy purchases" to Staff's energy estimates for TEP. In its Reply Brief, TEP argues that the new contestable load amounts in that exhibit have not been subject to cross-examination or other inquiry and should not be adopted in this Decision, particularly since Staff acknowledges those loads will be refined and adjusted in the Pre-Solicitation process.

credibility to the capacity and energy calculations for APS submitted by Staff, PGR and Harquahala.⁹ Harquahala believes that a specific number in terms of megawatts (representing capacity) and megawatt-hours (representing energy) should be included in the Decision on this matter, and supports using the numbers presented in Exh. S-5 as the minimum amounts for the utilities to competitively procure.

APS stated in its brief that although it finds the numbers set out in Exh. S-5 to be acceptable estimates of what they purport to be, with the caveat that reliability must-run generation (“RMR”) numbers may be revised upon completion of the ongoing RMR study,¹⁰ the numbers are estimates based on the information then currently available, and should not be viewed as any definitive indication of what APS may procure through the solicitation process.

TEP advocates that the Commission should clearly set out the types of load and the appropriate methodologies for determining contestable load, rather than adopting contestable load numbers that will require updating, and believes that a focus on methodology in this Track B Decision will meet the Commission’s goals for a competitive solicitation. Staff’s position is somewhat aligned with APS’ and TEP’s on this specific point, insofar as Staff believes that while the Commission will have to choose an appropriate number to represent the utilities’ contestable loads, those numbers should be targets, rather than absolute requirements. Staff recommends that the

⁹ Schedule PME-3R to Exh. APS-4 (Rebuttal Testimony of Peter M. Ewen), and Exh. No. CCR-1 to Exh. Panda-2 (Direct Testimony of Craig R. Roach, PhD), depict APS’ August Workshop estimates of the amount of APS generation it planned to displace with energy from what APS termed “PWEC Dedicated Generation.” Footnote 7 to Schedule PME-1, and Schedule PME-13 to Exh. APS-1 (Direct Testimony of Peter M. Ewen) depict APS’ Needs Assessment estimates of potential economy energy purchases and for net unmet reliability needs. A comparison is reproduced here for the years 2003-2005:

	APS’ August Workshop plans for PWEC displacement of APS generation energy	APS’ November Needs Assessment Plans for potential economy energy purchases	APS’ November Needs Assessment Plans for net unmet reliability needs
2003	5,728 GWH	3,705 GWH	639 GWH
2004	6,170 GWH	4,033 GWH	840 GWH
2005	7,217 GWH	6,695 GWH	1,228 GWH

¹⁰ APS added that even though Staff estimates of RMR and economy energy may be reasonable, APS believes it is inappropriate to include RMR and economy energy in the Track B solicitation process.

1 Commission focus on determining an appropriate method for calculating contestable load instead of
2 focusing on developing specific numbers, because it will be necessary to update the numbers prior to
3 the solicitation.

4 RUCO believes that the solicitation requirements beyond APS' and TEP's immediate needs
5 for the year 2003 should be determined by the Commission in an Integrated Resource Planning
6 ("IRP") process. RUCO takes the position that the Commission should establish the amount of
7 capacity, but not energy, for which the utilities should solicit bids. RUCO states that soliciting for
8 capacity is more important, because once the utility has sufficient capacity, the dispatch of that
9 capacity will be determined by the variable cost of each MW of capacity and the demand in each
10 hour. The LAW Fund took no position on the contestable load for the initial solicitation, stating that
11 it did not wish to delay the first round of solicitations, but advocated for mandatory inclusion of a
12 Demand Side Management ("DSM") solicitation component and an environmental risk management
13 policy in the second and subsequent solicitations.
14

15 b. Discussion/Resolution
16

17 At the hearing, Staff provided the following explanation of the purpose of its contestable load
18 estimates:

19 Staff's recommendation that this amount be solicited is not a recommendation that
20 necessarily the utilities purchase as a result of this first solicitation all of those
21 supplies, both capacity and energy that are offered or that are being solicited for. They
22 still have the obligation of evaluating those bids to see whether or not they are the
most economical and reasonable products to serve their customers' needs.

(Tr. at 156)

23 We agree with Staff on this point. We believe that the solicitation process developed by the
24 parties, as proposed by Staff, is a necessary step in our goal of encouraging the development of a
25 healthy competitive wholesale generation market in Arizona. We also recognize that the
26 responsibility of the utilities is to provide for the continuing need of its ratepayers to maintain a
27 reliable supply of electricity at reasonable rates, and that this primary obligation exists, and will
28

1 continue to exist, whether a utility has an affiliate operating in the Arizona wholesale market or not.
 2 TEP's position that we should only set out the types of load and the appropriate methodologies for
 3 determining contestable load, rather than adopting specific contestable load numbers that will require
 4 updating, might be acceptable under differing circumstances. However, at this time, we are faced
 5 with the fact that although the parties to this matter spent months working out numerous issues
 6 regarding the solicitation, they were unable to reach a consensus on contestable load amounts prior to
 7 the hearing. Because it is our desire to provide the parties as much clarity as possible on the
 8 parameters of the solicitation, we will adopt contestable load numbers for capacity and energy in this
 9 Decision, and will set out the appropriate methodology for refining and adjusting them in the Pre-
 10 Solicitation process. Our adoption of specific numbers for contestable load will not require the
 11 utilities to accept bids that they judge to be unreasonable, uneconomical, or unreliable pursuant to the
 12 bid evaluation requirements of this Decision.
 13

14 The major areas of disagreement regarding determination of contestable load numbers
 15 centered on whether contestable load should include RMR and economy energy purchases.
 16

17 **2. Reliability Must-Run Generation ("RMR")**

18 Transmission constraints currently limit the capacity and energy that can be delivered from
 19 particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and may
 20 give rise to RMR requirements inside those load pockets. (Exh. S-4 at 3-4 (Rebuttal Testimony of
 21 Jerry Smith))
 22

23 a. Inclusion of RMR in the Solicitation

24 1) Positions of the Parties

25 Staff believes that RMR should be included in the initial solicitation as contestable load,
 26 because such inclusion will reveal whether and to what extent the market will provide solutions to
 27 transmission import constraints (Tr. at 277-278). PPL, PGR, Harquahala, and WMGF are in
 28

1 agreement with Staff.¹¹ Staff states that failure to include RMR in a utility's contestable load has the
2 potential to diminish the benefits to be derived from competitive bidding, and would serve to
3 encourage the utility to continue using generating plants within a constrained area, and not look to
4 meet system needs from cheaper and cleaner sources. (Exh. S-4 at 3) Staff also believes that
5 inclusion of RMR in contestable load will offer a market response reference regarding the relative
6 economic and environmental merits of generation solutions to the transmission import constraint.
7 (Exh. S-4 at 6) Staff states that there are three conditions under which RMR capacity and energy
8 could be contestable: 1) if non-utility owned or non-rate based generation exists locally; 2) if remote
9 generation has access to non-APS or non-TEP firm transmission capacity that would enable delivery
10 to the local area; or 3) if owners of remote generation offer to finance transmission improvements to
11 remedy the transmission constraint. (Exh. S-4 at 5) Staff asserts that units exist internal to the
12 constraint that can bid, that transmission paths other than the incumbents' exist that could be used,
13 and that, at least in the long term, transmission enhancements could accompany an RMR bid. (Staff's
14 Initial Br. at 4, citing Tr. at 149-150, 151, 173-174, 279-280)

15
16
17 TEP opposes inclusion of RMR in the initial solicitation, as it believes that such a requirement
18 goes beyond the intent of Decision No. 65154. TEP argues that RMR is not suitable for the proposed
19 solicitation process, and that TEP cannot reasonably acquire RMR economically through that
20 process. TEP claims that the vast majority of its RMR needs are for voltage stabilization of the
21 system, and can only be served by TEP's local generation. TEP argues that given the nature of TEP's
22 service area, no realistic short-term RMR solutions are available on a competitive basis, and that all
23 three of Staff's factors on RMR contestability likely cannot be met for the TEP service area in the
24 short term. TEP disagrees with Staff's position that inclusion of RMR in the solicitation may lead to
25

26
27 ¹¹ PGR does not believe that it has yet been established that there presently should be either RMR capacity or
28 energy requirements, as it has not been allowed to participate in the RMR studies, and has seen no evidence that would
justify such requirements. However, PGR agrees that previously designated RMR capacity should be subject to
competitive solicitation.

1 long-term transmission enhancements, arguing that long-term solutions are contrary to the generally
2 anticipated 2003-2006 timeframe to be covered by the initial solicitation. TEP also believes that
3 including RMR in contestable load may significantly delay the initial solicitation, due to the interest
4 in RMR issues and the anticipated adjustment of RMR load numbers based on the January 2003
5 RMR study results. TEP also argues that soliciting and analyzing bids for RMR capacity and energy
6 involves issues beyond an analysis that focuses primarily on price. TEP urges that if the Commission
7 decides that RMR capacity should be competitively bid, that such bidding be deferred.
8

9 APS states that there is no precedent of which it is aware for bidding out company-owned
10 RMR capacity, that Staff took the position in the Track A proceeding that RMR should not be
11 divested, and that bidding APS-owned RMR runs the risk of ignoring the ancillary services benefits
12 offered by such RMR units, such as spinning reserve and voltage support. APS points out that it has
13 agreed to competitively bid for non-APS supplied RMR, and that this will allow for a “market test”
14 as suggested by Staff and some of the intervenors. APS argues that although the likelihood of
15 receiving a competing bid for the handful of hours served by APS-owned generation resources is
16 slight, the continued non-contestability of existing APS generation has important symbolic
17 significance in the financial community, and that there is no evidence on the record that making rate-
18 based assets contestable will benefit customers.
19

20 WMGF argues that whether APS-owned RMR does or does not provide ancillary services is
21 not a matter that affects whether such generation should be contestable in the competitive solicitation
22 process, because APS can simply include any required ancillary services in the bid solicitation, and
23 can consider their value during the bid evaluation process.
24

25 AUIA believes that inclusion of RMR in the 2003 solicitation does not serve a public purpose,
26 is premature prior to completion of the required RMR studies, and may be destabilizing to utility
27 finances.
28

2) Discussion/Resolution

The possibility that a competitive solicitation for RMR may result in less costly, more efficient, cleaner solutions to load pocket problems places the solicitation of RMR generation clearly within the public interest. In regard to the utilities' and AUIA's concern regarding the effect on utility finances, since APS and TEP will make the decision as to how much competitive power to procure beyond their requirements that cannot be produced from their own existing assets, any financial impact of such procurements is within their control. The RMR studies, discussed below, should be completed in time to have the required information available in time for the Pre-Solicitation review process as outlined in the Staff Report. Inclusion of RMR in this initial solicitation is therefore not premature.

We agree with WMGF that whether APS-owned RMR does or does not provide ancillary services is not a matter that affects whether such generation should be contestable in the competitive solicitation process, because APS and TEP can simply include any required ancillary services in the bid solicitation, and can consider their value during the bid evaluation process.

TEP argued that all three of the conditions under which RMR capacity and energy could be contestable likely cannot be met for the TEP service area in the short term. Staff's witness testified, however, that he was aware of distributed generation and renewable facilities in the TEP service area. (Tr. at 279) Until the solicitation occurs, it remains unknown whether, as TEP claims, RMR is suitable for the proposed solicitation process and can reasonably be acquired economically through that process. We believe that many of the issues TEP raised can and should be addressed in the Pre-Solicitation process proposed in the Staff Report following the completion of the RMR study, in which TEP is a participant. TEP's participation in that study should also provide TEP an opportunity to prepare for the additional issues it states are involved in the RMR solicitation process. Regarding the long-term solutions to load pocket problems, although the Staff Report does generally anticipate a

1 2003-2006 timeframe, longer term RMR solicitations or offers should not be discouraged. As with
2 non-RMR bids, and consistent with our desire to encourage the development of a robust wholesale
3 generation market in Arizona, we expect both TEP and APS to give serious consideration to longer-
4 term bids as well as short term bids.

5 We find that it is reasonable and in the public interest that all generation that can reliably
6 deliver energy into the load pockets, under the RMR conditions outlined by Staff, should be allowed
7 to compete in a fair and open manner to supply energy and capacity to both APS and TEP. We will
8 therefore require that RMR capacity and energy resources, including both utility owned and non-
9 utility owned resources, be contestable in the competitive solicitation process to help resolve
10 Arizona's load pocket problems in the most economical, efficient and air quality and water issues-
11 friendly manner possible. Notwithstanding any other provisions of this Order, TEP and APS shall
12 evaluate all bids, including those that may cover hours of the year designated as RMR hours, to
13 determine whether or not they provide benefits to consumers.
14

15 b. Separate vs. concurrent solicitation of RMR capacity and energy

16 1) Positions of the Parties

17
18 APS and TEP propose that if RMR capacity and energy must be solicited, that the solicitation
19 should be conducted separately from the initial solicitation. APS believes that the unique delivery
20 issues associated with non-APS owned RMR needs, which it does not oppose being made
21 contestable, merit separate consideration. PGR agrees that a solicitation for RMR requirements
22 should be conducted as part of the Track B solicitation, but separately from the solicitation for non-
23 RMR requirements. PGR argues that by carving out RMR from the solicitation that bidders may be
24 able to make better deals for capacity and energy because they know that other capacity and energy
25 would be used to provide RMR service during RMR hours.
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1 Staff believes that inclusion of RMR capacity and energy in the initial solicitation is necessary
2 to determine to what extent the market will provide solutions to transmission import constraints.
3 RUCO, in advocating for its least-cost planning process, asserts that RMR and non-RMR needs must
4 be evaluated simultaneously, because the least-cost RMR and non-RMR portfolios will affect one
5 another. Harquahala and PPL are also opposed to the RMR solicitation being addressed separately.

6 2) Discussion/Resolution

7 We agree with Staff that inclusion of RMR capacity and energy in the initial solicitation is
8 necessary to determine to what extent the market will provide solutions to transmission import
9 constraints. We also agree with RUCO that RMR and non-RMR needs should be evaluated
10 simultaneously, in order to determine the utility's best least-cost portfolio. We will therefore require
11 that RMR capacity and energy be included in the initial solicitation. We believe that the issue of
12 whether RMR is included in the same RFP or auction block with non-RMR capacity and energy in
13 this initial solicitation will be adequately addressed during the Pre-Solicitation process described in
14 the Staff Report. Whichever means the utilities use to solicit RMR, they must adhere to the goal of
15 obtaining reliable power for their customers at the most reasonable cost possible, while also keeping
16 in mind the air quality and water issues effects of their procurement decisions.

17 c. RMR Studies

18 APS, Salt River Project, TEP and the Western Area Power Administration are currently
19 participating in RMR studies for the years 2003-2005 to be filed by APS and TEP with the
20 Commission by January 31, 2003, and which are to include the identification of RMR hours, capacity
21 and energy. (Tr. at 147, 150; Exh. S-4 at 5) Staff states that the resulting study information will then
22 be available to incorporate in the pre-solicitation activities of the 2003 competitive solicitation
23 process. Staff anticipates that, once the RMR study reports are filed, parties will have an opportunity
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1 to comment on and critique them, and Staff would utilize those comments as a means of judging the
2 merits of the study results. (Tr. at 151-152)

3 PPL, Harquahala and PGR expressed concern that the merchant intervenors were not
4 participants in the RMR studies. PGR requests that the Commission order that merchant intervenors
5 be allowed to participate and comment. Staff testified that the transmission providers are under a
6 short time constraint to complete the study work, and that Staff believes that as long as the process
7 ends up with the opportunity for comment and review that the public interest will be served. (Tr. At
8 148) PPL believes that our Decision in this matter should address the substance and timing of non-
9 utility participation in review and comment on the study, and that substantive response and
10 modification, if called for by the “informed and credible” comments from recognized authorities, be
11 required. PPL believes that the critical impact of the studies upon the competitive solicitation and its
12 economic impacts on Arizona ratepayers mandate that such a meaningful “peer review” component
13 be built into the process as part of our Decision in this matter, and further believes that once RMR
14 conditions are quantified, that the Commission should continue to monitor the situation, as active
15 monitoring may lead to a better understanding of the physical constraints and solutions to help
16 resolve the RMR condition, and deter any biased operation of the system.

19 We believe that the anticipated Staff and Independent Evaluator review of comments from
20 non-utilities in response to the January, 2003 RMR studies will allow Staff and the Independent
21 Evaluator to judge the merits of the study results and properly apply the results during the Pre-
22 Solicitation process outlined in the Staff Report. PPL’s concerns regarding continuing monitoring of
23 RMR conditions are being met by Staff’s ongoing BTA process. If PPL has specific continuing
24 concerns, it may consult with Staff.

26 ...

27 ...

d. RMR Bid and Management Protocols

Staff recommends that RMR capacity and energy be bid and managed in accordance with applicable Arizona Independent Scheduling Administrator (“AISA”) and West Connect protocols. (Tr. at 350-352) TEP claims that this creates a dilemma for TEP because it would require TEP to seek a market-based solution for RMR at the same time that TEP’s FERC Open Access Transmission Tariff (“OATT”) requires RMR to be provided at a cost basis. APS acknowledges that bidding RMR could require amendments to OATT tariffs. (APS Initial Br. at 10) WMGF agrees with Staff, and points out that the AISA and West Connect protocols are known, and would limit the price for the utility to incremental cost until WestConnect is operational, when market prices would be allowed. (Tr. at 350-352)

A utility’s existing OATT can be amended if it becomes necessary to do so in order to allow a utility to charge lower rates to its customers as a result of a favorable RMR bid. It is highly unlikely that the Federal Energy Regulatory Commission (“FERC”) would be opposed to a utility obtaining the benefit for its customers of lower RMR costs, if the utility were to receive a bid lower than its incremental RMR costs. The RMR bid and management protocols should conform to the AISA or WestConnect protocols, whichever protocols are in place on a given date. We believe that contracting parties can adequately and effectively deal with the hypothetical event (*see* Tr. at 352) that neither set of protocols are in effect at some time in the future.

e. Yuma area

WMGF disagrees with APS’ position that existing transmission counterflows in the Yuma area, which result from two Yuma area generators selling power into California (Tr. at 667), obviate the need for APS to solicit RMR generation for the Yuma area. WMGF claims that because APS’ customers have no assurance that this no-cost transmission “service” will be available when needed,

1 that APS should not be allowed to use the existence of the counterflows in the competitive
2 solicitation evaluation process.

3 APS responds that the fact that APS can take advantage of local generation support provided
4 by two non-APS units that sell outside the Yuma area, at no cost to APS customers, so that APS can
5 use local generation only when necessary, does not support requiring APS to buy products from
6 WMGF that it does not need. APS views the WMGF project as one of several possible future
7 resources for meeting load-serving obligations in Yuma, but states that the proposed WMGF project
8 is by no means the only option APS has to address future load-serving capability at Yuma. (Exh.
9 APS-7 at 6 (Rebuttal Testimony of Thomas Glock)) APS states that it would not want to foreclose
10 other options by committing now to a project that does not have either a Certificate of Environmental
11 Compatibility or any financing, particularly given today's difficult credit environment. (*Id.*)

13 The same solicitation parameters for RMR capacity and generation will apply to APS for the
14 Yuma area as for the Phoenix area. A determination of whether RMR in the Yuma area is
15 contestable will be dependent upon the results of the forthcoming RMR studies, and Staff and the
16 Independent Evaluator's review of comments filed on those results. If there is contestable load in the
17 Yuma area, as determined in the Pre-Solicitation process by Staff and the Independent Evaluator after
18 their review of comments submitted on the RMR study results, APS will be required to solicit bids.
19 WMGF may make a proposal to APS, and as with all bids received, it will be up to the utility to
20 determine whether it is in the best interests of its ratepayers to procure a product or products from
21 WMGF in this solicitation.
22

23 3. Economy Energy – Solicitation versus Spot Market Purchases

24 a. APS

25 In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule
26 PME-1 attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B
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solicitation. APS proposed to displace production¹² from its existing generating assets and its SRP T&C contract not by solicitation in the Track B process, but only by purchases made outside the solicitation process, in the same manner that it currently makes such purchases. (Exh. APS-1 at 22-23; Exh. APS-2 at 13-14) APS showed these amounts in Schedule PME-13 to APS-1, which is titled “Potential Economy Energy Purchases.”¹³ APS explained that it currently determines whether to secure economy energy and other short-term purchases on a daily basis, based on a comparison of the anticipated market price of power and forward gas prices. (Exh. APS-2 at 13-14) In rebuttal testimony, APS proposed a compromise involving bidding 50 percent of its Needs Assessment forecast economy energy needs for the upcoming 12 months, outside the initial solicitation process, through a series of quarterly auctions held on the first business day of the month preceding each quarter, with the balance of APS’ economy and other short-term energy needs being acquired from non-affiliates or through “blind” procurements using electronic trading platforms or independent brokers, also outside the initial solicitation process. (Exh. APS-5 at 10-13 (Carlson Rebuttal Testimony)) APS argued that this would be the “least-harmful” way to test the viability of a formal solicitation process for “economy energy.”

Staff, Harquahala, and PGR are opposed to both of APS’ proposals. Staff characterized the type of purchase described by APS as spot market purchases, and stated that it is not opposed to APS acquiring energy on the spot market, as long as APS makes every effort to solicit for all of its needs in a fair and transparent solicitation. (Exh. S-3 at 8-9) Staff believes that the initial solicitation should include all the additional capacity that APS and TEP believe they will need for the period covered by the solicitation, and all of the energy that they expect to purchase from third parties for the specified time period, in order to determine market prices for both capacity and energy and to

¹² Schedule PME-1 already reflects APS’ plans to retire the 4MW Childs/Irving hydro facilities at the end of 2004 and to place the older West Phoenix steam units 4 and 6 in cold reserve for the years 2003 through 2012. (Exh. APS-1 at 18)

¹³ These amounts are also reproduced for the years 2003-2005 in footnote 9, above.

1 then assess the risks of alternative supply scenarios. (*Id.*) Staff believes that such a solicitation will
 2 reveal whether there is energy on the market that is priced in a way to make the spot market
 3 unattractive. (*Id.* at 10) Staff explained that a utility might find that firm energy is available at prices
 4 that make the potential benefits of the spot market, with its price volatility, unattractive, and might
 5 also find that dispatchable energy is available at prices below the utility's marginal costs of
 6 generation. (*Id.*) Staff believes that under those circumstances, locking in dispatchable energy
 7 during the initial solicitation will assure some consumer benefits while still allowing the utility to
 8 maintain the flexibility to go to the spot market when circumstances dictate. (*Id.*) PPL also believes
 9 that utilities should be allowed to make economy purchases, but that they should not use this practice
 10 as a means of avoiding and frustrating the essence of the competitive solicitation requirement. PPL
 11 argues that the Commission should require APS to bid almost all of the economy energy purchases
 12 identified in the Needs Assessment.
 13

14 PGR claims that a comparison of Schedule PME-1 to Exh. APS-1, which appears in APS'
 15 Needs Assessment, to an APS Load and Resource Forecast table presented at the August 13 and 14,
 16 2002 workshop¹⁴ demonstrates that APS, with its economy energy plan, hopes to subvert the
 17 solicitation and instead purchase from PWEC's Redhawk plant at spot market prices. (Exh. Panda-2
 18 at 15) PGR states that these two documents evidence a change from an APS proposal, in August
 19 2002, to acquire energy on the basis of a 38 percent to 41 percent average annual capacity factor, to a
 20 6 percent capacity factor¹⁵ in APS' Schedule PME-1. (*Id.*) PGR's witness stated that APS' August
 21 workshop table shows that what APS termed "PWEC Dedicated Generation,"¹⁶ with 1,700 MW of
 22 capacity, would generate 6,170 GWH of energy in 2004 to displace APS generation, which equates to
 23
 24

25
 26 ¹⁴ The referenced table is reproduced in Exh. No. CCR-1 attached to hearing Exh. Panda-2 (Direct Testimony of
 Craig R. Roach, PhD). *See also* footnote 9, above.

27 ¹⁵ "Capacity factor" is the percentage of hours a generating unit is actually in operation out of the hours it is
 available.

28 ¹⁶ Identified on Exhibit CCR-1 to Exh. Panda-2 as West Phoenix CC Units 4 & 5, Saguaro CT Unit 3, and
 Redhawk CC Units 1&2.

1 a 41 percent capacity factor in that year. *(d.)* PGR's witness pointed out that in November's
2 Schedule PME-1, for the same year 2004, and for approximately the same amount of capacity (1,634
3 MW), APS used a capacity factor of only 6 percent to reach its energy estimate of only 840 GWH for
4 acquisition in the solicitation for 2004, and to possibly acquire 4,033 GWH of energy as "economy
5 energy purchases." (*See* Schedule PME-1, fn 7, Schedule PME-13 to APS-1, Exhibit CCR-1 to Exh.
6 Panda-2 and Schedule PME-3R to Exh. APS-4) PGR asserts that APS reduced its planned capacity
7 factor for its energy solicitations when it became clear that PWEC's generation units might not
8 supply the energy to displace APS generation.
9

10 Harquahala, PGR, and PPL are also opposed to APS' proposed "compromise" to bid 50
11 percent of its forecast "economy energy" needs outside the initial solicitation process, through a
12 series of quarterly auctions. Harquahala asserts that APS' compromise solicitation process is an
13 attempt to delay significant competitive procurement until after APS can make its case for including
14 the PWEC units in rate base in the upcoming rate case. Reliant, however, in line with its position that
15 an auction should be held for at least one-third of the utilities' contestable load, supports the
16 Commission requiring adoption of APS' proposal for both APS and TEP to solicit economy energy.
17 Reliant suggests that if the auction process provides Arizona's consumers the benefits desired by the
18 Commission, that the Commission consider it as its policy for Arizona and possible future expansion
19 beyond 50 percent of economy energy. AUIA argues that APS should have the choice of meeting its
20 energy requirements in the manner of its choosing.
21

22 APS believes that the appropriate benchmark for determining whether pre-bidding economy
23 purchases is better for customers is not simply whether a generator can beat a current estimate of the
24 future operating costs of a particular APS generator. Rather, APS argues, the correct questions are
25 whether 1) placing restrictions on how APS procures economy energy in Track B and 2) requiring the
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1 procurement to occur far earlier than would otherwise be the case yield a better result than simply
2 continuing with an already proven and successful economy energy program.

3 The Commission does not discourage the appropriate use of economy purchases for utilities to
4 reduce energy costs to customers. The utilities should retain the ability to fill unplanned or
5 unexpected needs from the spot market when appropriate. However, the record in this proceeding
6 demonstrates that prior to Decision No. 65154, APS was considering a procurement strategy that was
7 not dependent upon spot market purchases for such a large amount of its energy needs, but instead
8 anticipated displacement of APS generating assets with power from its affiliate, PWEC. We do not
9 believe that including in contestable load what APS has termed “economy energy” amounts to
10 “placing restrictions on how APS procures economy energy” or “requiring procurement far earlier
11 than would otherwise be the case.” Rather, inclusion of these amounts simply requires that APS
12 solicit bids, in a fair and transparent process, for this energy. This solicitation is necessary so that
13 APS can determine, in its expertise, whether the procurement of such energy might yield a better
14 result than relying on the spot market. APS has previously made such a determination, as evidenced
15 by its prior plans to purchase a comparable amount of energy from its affiliate PWEC. (*see* Tr. at
16 525, 526) Without soliciting and evaluating bids from wholesale generators who have expressed a
17 keen interest in supplying APS’ anticipated energy needs, APS will forego the opportunity to
18 compare the costs of such procurement at today’s wholesale prices to its proposed economy energy
19 program. If APS determines that any or all bids received will not yield a better result than spot
20 market purchases, APS may reject them. We are requiring APS to solicit bids for this “economy
21 energy” amount to further the Commission’s goal, as set forth in Decision No. 65154, of encouraging
22 the development of a robust wholesale generation market in Arizona while at the same time
23 protecting Arizona ratepayers. In preparing the solicitations and in evaluating the bids received to
24 determine the wisest procurement strategy, the utilities must keep those goals in mind.
25
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1 APS' proposal of a quarterly auction process for solicitation of economy energy purchases, as
 2 a compromise to including the disputed economy energy in contestable load, is not the "least-
 3 harmful" way to test the viability of a formal solicitation process for economy energy. Based on the
 4 record in this proceeding, we find that postponing the solicitation of this portion of APS' contestable
 5 load may well prove harmful to the overall success of the solicitation process. The initial solicitation
 6 should include all anticipated third-party purchases in order to provide the utilities with the widest
 7 array of bids from which to compare and choose. Such a solicitation will best serve the goal of
 8 encouraging the development of a competitively robust wholesale generation market in Arizona
 9 without harming ratepayers.
 10

11 b. TEP

12 TEP urges that unplanned economy energy purchases should be excluded from contestable
 13 load, and agrees with Staff's position that utilities should retain their ability to fill unplanned or
 14 unexpected needs from the spot market when appropriate. TEP does not believe that it will derive
 15 any better-than-market benefits by bidding out economy energy through the formal solicitation
 16 process, particularly if it cannot accurately identify when it will need a certain amount of spot energy.
 17

18 **4. Capacity to be Solicited**

19 a. APS

20 Staff accepted APS' projected unmet capacity needs as set forth in Schedule PME-1 attached
 21 to its November 4, 2002 Needs Assessment, but added 15 percent reserves for all load.¹⁷ APS
 22 acknowledged that inclusion of reserves on all load, and not just APS load, could be appropriate.
 23 (Exh. APS-4 at 13-14) Staff also added APS' RMR capacity for the Phoenix area to its solicitation
 24 recommendation, but did not include RMR capacity for the Yuma area in its calculation due to the
 25

26
 27 ¹⁷ Staff agreed with PGR witness Roach's observation that reserves provided by bidders could easily be counted
 28 against requirements. Staff stated that recognizing bidders' reserves will also make it easier for the Staff and the
 Independent Monitor to compare the merits of alternative bids during the bid evaluation.

1 unavailability of the Yuma area data. Staff recommends that the final APS capacity solicitation
2 amounts be appropriately updated by the RMR capacity amount for the Yuma area when the results
3 of the RMR study are available, which should be on or before January 31, 2002. As currently set
4 forth in its updated version of hearing Exhibit S-5, attached hereto as Exhibit B, Staff recommends
5 that APS solicit bids for 2,460 MW of capacity in 2003; 2,734 MW of capacity in 2004; 2,854 MW
6 of capacity for 2005; and 2,950 MW of capacity for 2006, with those numbers to be updated by the
7 results of the RMR study.

8 PGR and Harquahala support Staff's recommended capacity solicitation amounts for APS.

9 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR
10 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
11 therefore require that APS' minimum capacity solicitation amounts conform to Staff's estimates as
12 set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
13 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
14 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
15 Pre-Solicitation process set forth in the Staff Report.

16
17
18 b. TEP

19 In order to reach its recommended capacity solicitation for TEP, Staff accepted TEP's retail
20 monthly peak hour demand forecast as set forth in Exhibit 5 attached to TEP's November 4, 2002
21 Needs Assessment, and subtracted the transmission import limit for the Tucson area. Staff's resulting
22 recommended capacity solicitation for TEP thus consists solely of RMR capacity being supplied by
23 local units. Staff recommends that TEP solicit bids for 758 MW of capacity in 2003; 824 MW of
24 capacity in 2004; 861 MW of capacity for 2005; and 898 MW of capacity for 2006.

25 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR
26 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
27
28

1 therefore require that TEP's minimum capacity solicitation amounts conform to Staff's estimates as
2 set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
3 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
4 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
5 Pre-Solicitation process set forth in the Staff Report.

6 **5. Energy to be Solicited**

7 a. APS

8
9 Staff recommends that APS solicit energy for each year 2003, 2004, 2005 and 2006 that
10 equals the sum of APS' unmet energy needs from Schedule PME-1 of its Needs Assessment; APS'
11 Phoenix supplied RMR energy from work papers supplied to the parties with its Needs Assessment;
12 APS' Yuma supplied RMR energy as determined in the RMR study due January 31, 2002; and APS'
13 "potential economy energy purchases" as set forth in Schedule PME-13 of its Needs Assessment.
14 Staff's recommended energy solicitation amounts, which it states require adjustment to include APS'
15 Yuma supplied RMR energy, are 4,381 GWH of energy for 2003; 4,963 GWH of energy for 2004;
16 8,088 GWH of energy for 2005; and 8,680 GWH of energy for 2006.

17
18 RUCO takes the position that whatever solicitation process is used, the bids solicited by each
19 distribution utility should not be limited with respect to the total amount of energy requested.

20 Harquahala fully supports the Commission requiring APS to solicit at least the quantities of
21 energy contained in Exh. S-5. PGR believes that APS should be required to solicit energy in at least
22 the amount APS previously anticipated would be supplied by PWEC's combined cycle units (*see* Tr.
23 at 184-185) and prefers that the energy numbers appearing in Exh. S-1 be used for APS in lieu of the
24 lower energy numbers appearing in Exh. S-5 or in the updated version of S-5 attached to Staff's
25 Initial Brief.
26
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28

1 We note that Staff testified that it anticipates that irrespective of the size of the actual
2 solicitation, based on the amount of capacity and energy that is available at this time, that either size
3 minimum solicitation [S-1 or S-5] would yield bids for capacity and energy significantly in excess of
4 either amount appearing in S-1 or S-5, and the utility would still have a sufficient array of capacity
5 products and energy products from which to select so that it could make the right procurement
6 decision. (Tr. at 172-173) We agree with that statement, and therefore find that there is no need to
7 require that the contestable energy numbers be set at Staff's estimates appearing in Exh. S-1.
8

9 We find Staff's energy estimates above to be reasonable, and find it reasonable for the RMR
10 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
11 therefore require that APS' minimum energy solicitation amounts conform to Staff's estimates as set
12 forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the addition of
13 the necessary RMR amounts as determined by Staff and the Independent Evaluator following their
14 receipt and review of comments to the January, 2003 RMR Study Results, during the Pre-Solicitation
15 process set forth in the Staff Report.
16

17 b. TEP

18 In formulating its recommendation for the amount of energy that TEP should solicit, Staff
19 utilized the energy amount included in Exhibit 2 attached to TEP's Needs Assessment, and added
20 local RMR generation and economy purchases supplied from information provided by TEP based on
21 a November 2, 2002 load forecast. Staff states it is likely that the energy solicitation numbers it
22 recommends for TEP will require adjustment as a result of the RMR study, and that its adjusted
23 energy numbers could potentially be as high as 1,000 GWH annually. Staff's recommendation, based
24 on the information available, for TEP's energy solicitation is as follows: that TEP should solicit bids
25 for 443 GWH of energy for 2003; 688 GWH of energy for 2004; 596 GWH of energy for 2005; and
26 561 GWH of energy for 2006.
27
28

1 We find Staff's energy estimates above to be reasonable, and find it reasonable for the RMR
2 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
3 therefore require that TEP's minimum energy solicitation amounts conform to Staff's estimates as set
4 forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the addition of
5 the necessary RMR amounts as determined by Staff and the Independent Evaluator following their
6 receipt and review of comments to the January, 2003 RMR Study Results, during the Pre-Solicitation
7 process set forth in the Staff Report.
8

9 **III. SOLICITATION/PROCUREMENT PROCESS**

10 **A. Solicitation Method - Auction vs. RFP**

11 The Staff Proposed Solicitation process includes procedures for both a descending clock
12 auction and a Request for Proposal ("RFP") process.

13 Reliant advocates that APS and TEP be required to solicit at least one-third of their
14 contestable load through an auction process. Reliant believes that such a requirement would not only
15 ensure that the utilities receive the lowest price for the product being solicited, but would ensure that
16 all competitors are offered a fair opportunity to participate and that the Commission is provided a
17 complete array of potential responses. Reliant claims the benefit of an auction is that it induces
18 vigorous competition for standard products. Reliant also asserts that the capacity products described
19 by TEP and APS in this proceeding are either already standard products or can be easily standardized
20 for procurement from today's wholesale electric markets.
21

22 RUCO argues that Reliant's auction methodology is flawed because an auction alone will not
23 reveal whether a winning bid can fit within a least cost portfolio of resources; and only a system
24 dispatch model can provide that answer. (Exh. RUCO-2 at 6-7 (Rebuttal Testimony of Dr. Richard
25 A. Rosen))
26
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1 PPL asserts that, as long as the principles of maintaining an open, transparent and unbiased
2 solicitation process are observed, the utilities should be allowed to establish the method of
3 solicitation, depending on which method the utility deems most appropriate for the type of product
4 being solicited.

5 APS states that, at this time, it favors an auction for future procurements, but that there is
6 insufficient time to develop an auction and accommodate all of the variables that require resolution
7 prior to the first solicitation.
8

9 We believe that the various types of bids that the parties propose in this proceeding will
10 encompass numerous variables, and agree with APS' assessment that there is insufficient time to
11 develop an auction to account for all those variables while meeting the deadline for the first
12 solicitation. Despite the fact that the parties have worked toward general agreement regarding this
13 solicitation, there is no general agreement of the parties on standard products, and such agreement
14 would be a requirement of a fair, open and transparent solicitation process through an auction. It is of
15 great importance that the utilities have the maximum amount of information available through bids in
16 order to determine which procurement will best serve the ratepayers' interests, and it appears that an
17 RFP will be the better means of providing the utilities with the broadest array of responses from
18 which to choose. Therefore, the proposals of APS and TEP for the first solicitation are approved, but
19 the utilities are encouraged to consider diverse procurement methods in future solicitations, including
20 auctions.
21

22 **B. Who may participate in the solicitation**
23

24 The LAW Fund asserts that all interested parties should be allowed to review and comment on
25 the bid solicitation materials; that the load forecast, resource plan and needs assessment should be
26 available for review by all interested parties; and that all interested parties should be allowed to
27 attend bidders conferences. (Exh. LAW-1 at 11-12 (Direct Testimony of Dr. David Berry)) The
28

1 LAW Fund believes that expanding the review to include other parties could allow interested parties
 2 other than bidders to identify provisions in the draft solicitation that needlessly restrict creative bids
 3 or dissuade potential bidders. (*Id.*)

4 The Staff Proposed Solicitation Process allows prospective bidders, and interested persons
 5 who agree to keep certain information confidential, to review and comment on the bid solicitation
 6 materials (Exh. S-1 at 8), to provide comments to the utility, the Independent Monitor or the Staff
 7 regarding the completeness or quality of the information provided and the process being employed or
 8 the decisions made regarding execution of the solicitation process (*id.*), and the opportunity to ask
 9 questions directly of the utility as well as to identify any deficiencies in the solicitation documents or
 10 supporting data. (*Id.* at 9) We believe that in conjunction with the utilities' November Needs
 11 Assessment filings, the Staff Proposed Solicitation Process adequately addresses the other issues
 12 raised by the LAW Fund for purposes of this initial solicitation. In a section below, we discuss other
 13 issues raised by the LAW Fund that may be addressed in subsequent solicitations. Depending on the
 14 outcome of the workshops that the LAW Fund has recommended, the issue of non-bidder
 15 participation for limited purposes may be revisited.
 16
 17

18 C. Product Definition

19 1. Unit-Contingent Bids

20 PGR requests that the Commission require APS to solicit asset-backed, dispatchable unit-
 21 contingent bids and enter into traditional pay-for performance PPAs to meet the majority of its needs.
 22 Harquahala supports PGR's request.¹⁸ PGR asserts that APS' proposed affiliate PPA anticipated the
 23
 24

25 ¹⁸ PGR proposes two types of bids: One would be a unit contingent offer with an availability guarantee of 95
 26 percent, and the second would be a firm LD offer that would include a 100 percent availability guarantee backed up by
 27 the requirement to pay for replacement capacity and energy if the 100 percent guarantee is not met (liquidated damages).
 28 PGR further recommends that the remaining amount of capacity to be procured should be met by seasonal firm LD call
 options. "Call options" means the utility has the right, but not the obligation, to call on the bidder during the summer
 months for either 16 peak hours in a day or in just 6 super-peak hours. All the calls are under day-ahead scheduling and
 once called to run, the unit would be guaranteed to run for the full 16 or 6 hours.

1 same unit-contingent portfolio that PGR is advocating in this proceeding.¹⁹ PGR believes that APS
 2 is likely to get better bids at lower prices for direct solicitation for unit contingent capacity and
 3 dispatchable energy than it would get if such bids were submitted as non-conforming bids in an RFP
 4 for other products. PGR points to APS' acknowledgement that it may not have time to consider bids
 5 not conforming to specific parameters of the products it decides to solicit (*see* Exh. APS-3 at 5) as
 6 support for its request that the Commission require APS to solicit the unit-contingent portfolio that
 7 PGR advocates. Further, PGR claims that it is only through solicitation of these products that APS
 8 and Staff can determine which portfolio of products is in the best interests of APS ratepayers.
 9

10 **2. Length of Contracts**

11 PPL asserts that in order to maximize the consumers' benefits from the current wholesale
 12 market, the utilities should seek some medium- and long-term contracts to lock in longer-term
 13 benefits of the current price situation. Sempra and SWPG likewise argue, in agreement with WMGF,
 14 that a well-conceived power procurement process should require that current market circumstances
 15 be considered and evaluated to determine if longer-term contract offerings could be used to lock in
 16 reasonable rates for electric consumers regardless of what happens in the volatile spot price
 17 wholesale market during the next few years, and recommend that a solicitation process be adopted
 18 that expressly considers intermediate and long-term contracts. Reliant generally agrees with PGR,
 19 Sempra, SWPG, WMGF and PPL that the Commission's Decision in this matter should encourage
 20 APS and TEP to solicit a variety of products with varying terms.
 21

22 WMGF asserts that a failure to seriously consider long-term contract proposals would be
 23 contrary to the Commission's stated intent in establishing the Track B solicitation process, which is
 24

25 . . .

27 ¹⁹ On October 18, 2001, APS filed a Request for a Partial Variance to A.A.C. R14-2-1606(B) and for Approval of a
 28 Purchase Power Agreement, Docket No E-01345A-01-0822, requesting authority to enter into a purchase power
 agreement with its affiliate PWECC.

1 to encourage the development of a robust wholesale market for generation in Arizona, to allow
2 consumers the benefits of new Arizona generation resources, while protecting ratepayers. Staff
3 agreed with WMGF that Arizona is currently experiencing low electricity prices due in part to
4 reduced demand for electricity coupled with a surplus of generation. (Tr. at 250-252) WMGF argues
5 that by developing a well-balanced portfolio of contracts, including some long-term contracts, which
6 would lock in current low electricity prices in this “buyers’ market,” the utilities will protect
7 ratepayers by shielding them from an uncertain future. WMGF recommended that the Decision in
8 this matter include language stating that ratepayers are best served if the utilities acquire through the
9 competitive solicitation process a well-balanced mixture of contracts, including contracts with terms
10 of up to 15 to 20 years, in order to protect ratepayers from future market price uncertainty, and to
11 allow new and proposed generating projects the opportunity to meaningfully participate in the
12 competitive solicitation process, since new power generation projects require long-term off-take
13 contracts to satisfy lenders’ requirements.
14

15 TEP believes that longer-term agreements should be considered, at the utility’s discretion, in
16 the solicitation process to enable necessary transmission infrastructure to be built and to insure that
17 the output from power plants located in Arizona stays in Arizona to meet its growing demand. (Exh.
18 TEP-2 at 10 (Rebuttal Testimony of David Hutchens))
19

20 PGR raised its concern with giving APS sole discretion to determine the term of any contract
21 given APS’ stated intent to seek rate base treatment of the PWEC generation, and asserts that such a
22 result would “completely obliterate” the Track B process and the instruction in Decision No. 65154
23 that those assets should not be treated as APS assets for the Track B solicitation.
24

25 The Staff Report states while during 2003 each utility is anticipated to primarily require
26 peaking capacity and energy with contract terms of one to three years, that each utility must
27 demonstrate that its power supply portfolio contract durations are adequately diversified and that its
28

1 portfolio's structure mitigates both cost and reliability risks appropriately, and that if, in the judgment
2 of the utility, market conditions or economic opportunities dictate contract terms longer than three
3 years, it will be the responsibility of the utility to enter into such contracts as are reasonable. (Exh. S-
4 1 at 6)

5 APS stated that it presently proposes to target its solicitation for the 3-4 years that Staff
6 acknowledged was most likely appropriate. APS also stated that while it will consider bids for longer
7 than the period covered by the initial solicitation, it does not believe that it should be required to
8 solicit for such products. APS argues that increasing risks are associated with longer-term contracts,
9 such as counter-party credit risk, regulatory risk, the potential implications of FERC's Standard
10 Market Design ("SMD") initiative, changes in future system needs, and potential customer attrition to
11 Direct Access in later years.

13 3. Discussion/Resolution

14 The evidence presented on the record in this proceeding supports a finding that both APS and
15 TEP should seriously evaluate and consider a well-balanced mixture of contracts, including long-term
16 contracts, in the competitive solicitation in order to protect ratepayers from future upswings in power
17 prices. In making its determination regarding the appropriate resource portfolio in the best interests
18 of its customers, APS should bear in mind the Commission's instruction in Decision No. 65154 that
19 the PWEC assets that it may seek rate base treatment for in the future should not be treated as APS
20 assets for the Track B solicitation. The Commission expects the utilities to make procurement
21 decisions that further the goal of encouraging the development of a vibrant wholesale generation
22 market in Arizona.
23
24

25 ...

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1 **D. Bid Evaluation**

2 **1. Production Modeling (Bid Evaluation)**

3 a. Positions of Parties

4 Sempra and SWPG advocated that the utilities perform a system-integrated analysis of bids
5 received using computer programs and modeling. They believe that such analysis would provide
6 some form of preliminary yardstick by which to measure the reasonableness of APS' and TEP's
7 actions. Staff's witness testified that it believed such a program would be an integral part of the
8 preparation of a needs assessment. (Tr. At 93) Both APS and TEP confirmed their intention to rely
9 on production modeling to evaluate the economics of bids and existing assets. (Tr. at 479, 489, 490,
10 Exh. APS-5 at 21) Sempra and SWPG assert that a longer time frame than that appearing in the Staff
11 Report may be required for the utilities to evaluate competitive proposals as to price and
12 deliverability using a system integration analysis, but do not believe that the time required need
13 extend the overall timeline beyond what the Staff Report contemplates. RUCO also believes that the
14 utilities must perform production cost simulations of the various combinations of resources to obtain
15 the least-cost result, and that the utilities will likely need 6-8 weeks to adequately review available
16 options before determining the most prudent course of action. (Exh. RUCO-2 at 7 (Rebuttal
17 Testimony of Dr. Richard A. Rosen)).

18 b. Discussion/Resolution

19 During the workshop process, the participants reached a consensus in developing the
20 Solicitation Timelines appearing in the Staff Report at pages 27-29. The record reflects that APS and
21 TEP were active participants in the workshops wherein the timelines were developed, and that APS
22 and TEP plan to utilize production modeling to evaluate the bids received. We therefore believe that
23 Sempra, SWPG, and RUCO's concerns will be adequately addressed. As to Sempra and SWPG's
24 assertion that the described analysis would provide some form of preliminary yardstick by which to
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1 measure the reasonableness of APS' and TEP's actions, we agree. As we have emphasized, the
2 utilities will be responsible for determining the best resource mix to provide reliable power to their
3 customers at the most reasonable cost possible, while taking air quality and water issues concerns
4 into account.

5 **2. RUCO - Least Cost Planning/Integrated Resource Planning**

6 a. Positions of Parties

7
8 RUCO believes that a comparison to the utilities' cost to generate power themselves is
9 appropriate to determine the reasonableness of bids received from independent power producers.
10 Based on its belief that such bids can serve as a baseline for evaluating bids from the unregulated
11 market, RUCO has called for a requirement for cost-of-service proxy bids, for new self-built
12 generation and transmission, from the incumbent utilities for purposes of such comparison. The
13 vehicle RUCO proposed for such comparison is the re-institution of a traditional integrated resource
14 planning ("IRP") process, in which the Commission would review the utilities' resource planning in
15 advance, such as the process in place at the Commission prior to Arizona's move toward the
16 restructuring of the Arizona electricity markets. RUCO believes that an added benefit of a new IRP
17 process would be that Demand-Side Management, transmission and generation resources (including
18 both RMR and non-RMR generation) could be evaluated simultaneously, and that IRP provides a
19 framework for addressing environmental implications, as well as cost implications, of resource
20 planning. In addition, RUCO asserts that an IRP process can address a number of other complex
21 issues, including the reasonableness of prices, the reliability and deliverability of the supply, the
22 creditworthiness of the counterparties, and short and long term impacts on customers.
23
24

25 RUCO proposed that because the time required for the institution of an IRP process exceeds
26 the time remaining for a solicitation of the utilities' 2003 requirements, that the utilities procure only
27 enough power for their 2003 capacity growth needs in the initial solicitation. Then, RUCO envisions
28

1 that the IRP process would take place, which process would include a determination of the total
2 present value of revenue requirements ("PVRR")²⁰ for all possible, technologically compatible
3 resource portfolios and a comparison of each portfolio's PVRR to the PVRR of all other such
4 portfolios over the relevant planning period. RUCO believes the planning horizon over which the
5 PVRR should be measured should extend over 20, and perhaps 30 years. RUCO believes that after
6 the bids are evaluated, the utilities should reject, as imprudent, market bids that exceed the utilities'
7 cost of service proxy bids; acquire the mix of the remaining market bids that would result in the least
8 cost to consumers; and if the remaining bids do not meet the utilities' needs, the utilities should
9 acquire the mix of merchant-bid and utility self-build resources that will result in the least cost to
10 consumers.
11

12 Staff states that a responsible utility should use least cost planning principles to develop its
13 overall portfolio. Staff also states that least cost planning principles are present in the Pre-
14 Solicitation process outlined in the Staff Report, which requires each utility to prepare load
15 assessments, needs assessments, price forecasts, and various other documentation that Staff and the
16 Independent Monitor would review. In response to RUCO's position that the Commission should be
17 more involved in the planning process, Staff states that whatever the merits of RUCO's suggestions
18 in this issue may be, a decision on institution of an IRP process is beyond the scope of this
19 proceeding.
20

21 APS supports Staff's position on IRP, and adds that while it is a significant issue, it should
22
23
24
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26

27 ²⁰ RUCO emphasizes that there is a difference between PVRR and Harquahala's recommended net present value of
28 rate impacts for bid evaluation, which RUCO does not believe minimizes the total cost of a given resource portfolio to
consumers.

1 not complicate an already complex solicitation process with an already challenging implementation
2 timeline. APS comments that an IRP process, if done in the future, would necessarily be limited and
3 constrained by procurement decisions previously made in the initial solicitation.

4 The LAW Fund opposes the use of either PVRR or the net present value of rate impacts test
5 proposed by Harquahala to determine resource portfolio, because the tests may not accurately reflect
6 the benefits of DSM or correctly incorporate environmental impacts of power production.

7 Reliant agrees that the competitive solicitation should result in a least-cost mix of supplies for
8 the benefit of Arizona's consumers, but asserts that it is the utilities' responsibility to determine this
9 mix and that a time-consuming IRP process is not necessary. Reliant agrees with Staff that RUCO's
10 suggestions are beyond the scope of this proceeding, but is supportive of APS' proposal that, to the
11 extent the Commission wishes to consider the issue further, additional workshops be scheduled to
12 address it.
13

14 b. Discussion/Resolution

15 We do not disagree with the goals of RUCO's proposed institution of an IRP process, namely,
16 obtaining the least-cost resources for Arizona consumers, and we expect that the utilities will use
17 least cost planning principles to develop their overall portfolios. We believe that the Staff Proposed
18 Solicitation Process, its bid evaluation criteria (*see* Exh. S-1 at 18) and the utilities' stated intentions
19 to utilize production modeling to evaluate the bids received, will encompass the majority of the IRP
20 concepts advocated by RUCO, and will not require the Commission to be an active participant in the
21 utilities' planning and procurement processes. We find that based on the record in this Track B
22 proceeding, re-institution of an integrated resource planning process is not necessary to protect the
23 public interest.
24
25

26 ...

27 ...

1 **3. LAW Fund - Demand Side Management (“DSM”) and Environmental**
2 **Risk Management**

3 a. Environmental Risk Management

4 The LAW Fund asserts that environmental improvement will not be achieved through the
5 resource acquisition process, or will occur only by happenstance, unless the Commission takes
6 explicit, proactive steps to ensure that environmental factors are integrated into the competitive
7 solicitation process.²¹ The LAW Fund proposed a series of steps to Commission adoption of an
8 environmental risk management policy through a series of workshops and hearings. (*See Exhibit*
9 *DB-3 to Exh. LAW-1 (Direct Testimony of Dr. David Berry)*) The LAW Fund states that as a
10 practical matter, the Commission’s desire to implement Track B expeditiously means that there will
11 not be time to integrate consideration of environmental performance into the first round of
12 competitive solicitation, but urges the Commission to act now to ensure that an environmental risk
13 management policy is in place in time for the second and subsequent solicitations.
14

15 b. DSM

16 The LAW Fund believes that cost effective DSM is a resource that can help meet the demand
17 for electric energy services at lower cost than conventional generation resources, and that because
18 DSM displaces electricity and generally has a stable cost, it helps consumers and utilities avoid
19 fluctuations in the price of electricity and natural gas used to generate electricity. The LAW Fund
20 states that DSM may reduce or eliminate the need for more transmission or distribution capacity, may
21 avoid transmission constraints, and can reduce the environmental impacts of electricity consumption,
22 including compliance costs associated with future environmental regulation. (*See Exh. LAW-1 at 2*)
23 The LAW Fund proposed a series of steps to Commission adoption of a Demand Side Management
24 Policy through a series of workshops and hearings. (*See Exhibit DB-2 to Exh. LAW-1 (Direct*
25
26

27 _____
28 ²¹ The LAW Fund noted that other than the APS plans to retire the Childs/Irving hydro facility and the older West Phoenix units, there are no current plans to retire any other environmentally undesirable units.

1 Testimony of Dr. David Berry)) As with its recommendations regarding Commission institution of
2 an environmental risk management policy, the LAW Fund advises that the DSM policy process be
3 begun quickly so that it can be comprehensively reviewed and completed in time to be applied as
4 inputs to the second and subsequent rounds of competitive solicitations.

5 Staff states that bidders are free to submit bids that include DSM and environmental risk
6 management in response to a utility solicitation, but that such bids should not be required in the initial
7 solicitation. Semptra and SWPG agree.

8
9 c. Discussion/Resolution

10 We appreciate the concerns of the LAW Fund regarding DSM and environmental risk
11 management policy. While we do not discourage the consideration of DSM in the initial solicitation,
12 we agree that workshops to address DSM issues and the development of a DSM acquisition process
13 are in the public interest. Likewise, we believe that workshops on the development of an
14 environmental risk management policy will provide a forum for a discussion of the costs and benefits
15 of environmental mitigation. We will therefore require that Staff facilitate a workshop process to
16 explore the development of a DSM policy and an environmental risk management policy, with such
17 exploration to include an examination of the possible costs and benefits of the respective policies, and
18 to file a report informing the Commission of the progress achieved in the workshops, including a
19 Staff recommendation on whether hearings should be held as suggested in Exhibits DB-2 and DB-3
20 to Exh. LAW-1.

21
22 In a somewhat related recommendation, the LAW Fund has recommended that Staff and the
23 Independent Monitor be required to provide, as part of their reports pursuant to the Staff Proposed
24 Solicitation Process, environmental information including information on air emissions and water
25 usage of the resources acquired and of the utilities' entire portfolios. The LAW Fund believes that
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1 this information would be instructive for the Commission to evaluate whether the competitive
2 solicitation process would result in improved environmental performance.

3 This initial solicitation will largely be concerned with currently planned and existing
4 generation supply, the environmental effects of which have already been largely determined. We
5 believe that even without the additional requirement that the LAW Fund wishes us to impose, that the
6 duties of the utilities, the Staff and the Independent Evaluator will be very time-consuming in this
7 initial solicitation, and we do not believe that the extra burden that the recommended requirement
8 would place on the process would yield results justifying the burden. This issue should instead be
9 examined in the workshop addressing environmental risk management.
10

11 **4. Environmental Portfolio Standard (“EPS”)**

12 WGMF asserts that generators with a renewable resource component should be permitted to
13 make proposals in the competitive solicitation, and that such proposals should receive appropriate
14 credit in recognition of the “added value” they provide the utilities in meeting their renewable
15 resource requirements under the EPS. WGMF urges that the Decision in this matter specifically state
16 that such proposals may be submitted, that the utilities should consider these proposals in meeting
17 their unmet renewable resource needs under the EPS, and that the utilities should explicitly credit
18 such proposals with the added value they provide the utility in meeting its renewable energy
19 requirements under the EPS.²²
20

21 APS agrees that proposals may be submitted to meet APS’ needs as part of the general
22 procurement process, but does not believe that it should be required to include its EPS requirement in
23 the solicitation, or that renewable proposals should receive any preference in the general procurement
24 process. (Tr. at 691, 699) APS noted at the hearing that it currently has an EPS RFP outstanding.
25
26

27 ²² WGMF asserts that the Commission should adopt the following method for calculating such a credit: add
28 monies collected by the utility from its ratepayers under the EPS surcharges, and divide this amount by the total MWH
that APS must purchase from renewable energy providers in compliance with the EPS.

1 Staff states that bidders are free to submit bids that include renewable resources in response to
2 a utility solicitation, but that such bids should not be required in the initial solicitation.

3 We agree with APS and Staff. While we are not opposed to the concept of a utility giving a
4 preference to environmentally-friendly generation in its bid evaluation, we do not believe at this time
5 that the record in this proceeding supports the imposition of such a requirement.

6 **5. Ability to Reject All Offers**

7 Staff states that the utilities should have the right to reject all bids if the bids do not
8 reasonably meet the needs of the utility and its customers, and that since the utilities are obligated to
9 supply electricity to their customers in a prudent manner, they will have an obligation to reject
10 uneconomic bids.
11

12 PGR agrees with Staff that the utilities should be able to reject all bids if it is truly in the
13 ratepayers' interest. PGR urges that the Commission articulate clear expectations of the
14 circumstances under which the utilities will be expected to contract with bidders, such as when the
15 utilities can "lock in" ratepayer savings. Harquahala supports PGR in this. AUIA urges that the
16 utilities be given the flexibility to carry out the responsibilities for which they will be held
17 accountable.
18

19 We agree with Staff and AUIA, and will again clarify that the utilities have the right to reject
20 all bids if the bids do not reasonably meet the needs of the utility and its customers. We do expect
21 the utilities to give serious consideration to all bids received, including long- and short-term bids,
22 which consideration should include sound economic and deliverability analysis of the bids. The
23 utilities' goal should be to obtain for their customers the least-cost mix of reliable power over the
24 long term, while being mindful of the air quality and water issues effects of their procurement
25 decisions, as well as whether their procurement decisions will further this Commission's goal of
26 encouraging the development of a competitive wholesale generation market in Arizona. While we
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are not requiring APS and TEP to accept bids in the solicitation process that are unreasonable, uneconomical, or unreliable, APS and TEP should be on notice that the Commission will closely scrutinize the offered bids and the utilities' procurement decisions based on those bids for conformity with those goals. If the utility accepts no bids, the utility shall notify the Commission by filing a detailed written explanation within 72 hours after its decision. The Commission may take whatever action it deems appropriate at that time.

IV. AFFILIATE PARTICIPATION/STANDARDS OF CONDUCT

A. APS

1. Information sharing between APS and its affiliates

PGR, Reliant, and Harquahala believe that information sharing between APS and its affiliates may create an unfair competitive advantage to PWEC, and recommend that measures be taken to prevent such sharing. PGR points out that Pinnacle West Capital Corp. ("Pinnacle West") has all APS unit cost information, as it has been performing APS' generation dispatch on unit commitment decisions (Tr. at 604-606), and would continue to have access to such information under the terms of the "confidential information" and "shared services" sections of the proposed Code of Conduct that APS has filed pursuant to Decision No. 65154. (Tr. At 607) Reliant also recognized that such information sharing gives the competitive electric affiliate an advantage during dispatch protocol. Reliant recommended that the Commission require APS to adopt a Code of Conduct prohibiting its affiliates that intend to participate in the solicitation from handling system dispatch, risk management or contract management for APS or receiving information from APS (directly or indirectly) that would advantage them in the solicitation process. Reliant stated that if such information sharing cannot be avoided, the remedy should be that in the short term, all participants in the competitive process should be provided the same information about APS and its products as is available to PWEC.

2. APS conduct of its solicitation process

PGR has requested that the Independent Monitor run the solicitation process for APS, and Harquahala has stated its agreement with PGR on this point. PGR believes that the contemplated participation of APS' merchant affiliate in the proposed solicitation makes third-party independent management of the APS solicitation necessary, and further submits that on the basis of the testimony, actions and filings by APS regarding its affiliate,²³ that the showing referred to in the Staff Report has been made that an independent party should manage the APS solicitation and have the final say in determining the acceptable products and winning bidders. PGR asserts that it is only through such oversight that the Commission can ensure that ratepayer benefits are not displaced by affiliate preferences.

The Staff Proposed Solicitation Process provides that absent evidence of abuse, the utility will be responsible for preparing the solicitation and conducting the solicitation process. (Exh. S-1 at 8) It also provides that if the Commission finds that the utility failed to conduct an appropriate solicitation, the Commission may order that a new solicitation be conducted by an independent party. (*Id.* at 12) Staff also addressed this issue in the section of its Staff Report addressing unresolved issues, and is of the opinion that the judgment of a third party should not, in the ordinary situation, be substituted for that of the utility. (Exh. S-1 at 37) Staff believes, however, that the Commission should, through the Staff and an Independent Monitor, review the actions of the utility and be prepared to appoint a third party to conduct the solicitation should the utility fail to conduct a fair and

...

...

²³ PGR believes that APS' pending \$500 million refinancing proposal, if approved, would provide a significant competitive advantage to APS' merchant affiliate, and in addition, if APS had \$500 million invested in PWEC, that APS would have a substantial interest in assuring that PWEC is successful in the competitive solicitation. Harquahala claims that APS' stated intent, in the financing request, to request rate base treatment of PWEC assets in the upcoming rate case, if granted, would provide a year-round capacity payment to those affiliate assets.

1 transparent solicitation. (*Id.*) In particular, Staff believes that should there be any evidence of
2 improper contact between the utility and an affiliate, the Commission should have a third party
3 conduct the solicitation if it is determined that the contact was a material violation of the standard of
4 conduct. (*Id.*)

5 Staff believes that the Commission should leave the obligation to appropriately conduct the
6 solicitation and to select bids with the utility, (Tr. at 192) that the utility has the expertise to best
7 determine the products that it needs to fulfill its obligations to its customers to provide reliable
8 service at reasonable cost, (Tr. at 188-189, 303) and that as compared to Staff and the Independent
9 Monitor, the utility is best-positioned to make an informed decision when it evaluates bids. (*Id.*)
10 Staff believes that the oversight provided by the Independent Monitor as well as Staff participation
11 provide an appropriate level of involvement to ensure that the utilities act in the best interests of
12 customers.
13

14 APS agrees with Staff that the utility needs to be the decision-maker on the products, process
15 and selection of winning bids. APS responds to PGR and Harquahala that the fact that APS has
16 publicly filed the financing application, and has publicly discussed its intent to seek rate base
17 treatment of the PWEC assets in the upcoming rate case, does not mean that APS will conduct the
18 solicitation unfairly or in bad faith.
19

20 3. Standards of Conduct

21 The Staff Report outlines a process by which Staff believes a utility should submit a draft
22 standard of conduct to Staff and the Independent Monitor, and following a discussion of changes, the
23 draft should be shared with prospective bidders. The Staff Report process outline includes
24 completion of a draft standard of conduct by the end of January 2003. (Exh. S-1 at 37-38) The Staff
25 Report sets forth the minimum requirements for an acceptable standard of conduct, which will
26 include monitoring by Staff and the Independent Monitor of the solicitation process. (*See id.*) Staff
27
28

1 testified that the standard of conduct is intended to ensure that the utility and its affiliate have
2 procedures in place to provide for separation of information, rather than complete separation of
3 function. (Tr. at 139-140)

4 PGR believes that it is necessary as part of this Track B proceeding to ensure that adequate
5 protections are written into the Track B process and coordinated with the Code of Conduct, which, as
6 PGR notes, is still subject to a separate hearing. PGR believes that the Track B standards of conduct
7 must, in coordination with APS' Code of Conduct, at a minimum: 1) eliminate all affiliate
8 preferences; 2) require APS to treat all suppliers, both affiliated and non-affiliated, in a non-
9 discriminatory fashion; 3) keep the utility and its affiliate completely separate during the solicitation
10 process; and 4) contain effective enforcement and penalty provisions.

12 Staff stated that it recognizes that there are shared services between APS and Pinnacle West
13 that cannot realistically be separated or reorganized in time for the first solicitation. (Tr. at 139-140)
14 Staff states in its Reply Brief that although it would be ideal for the Commission to review the
15 standards of conduct in a separate proceeding, the timing for the Track B solicitation does not allow
16 enough time to complete such a proceeding. Staff proposed that the standards of conduct be
17 addressed in the Pre-Solicitation materials, rather than by Commission order.

19 Reliant is generally supportive of Staff's position regarding standards of conduct outlined in
20 the Staff Report, except to the extent it could be construed as allowing APS and Pinnacle West to
21 share services related to system dispatch, risk management or contract management. Reliant asserts
22 that these areas provide access to information that creates an unfair competitive advantage to the
23 affiliate and must not be permitted.

25 APS' witness testified that the separation of Pinnacle West employees who are dispatching
26 the system and who would thereby know APS' costs of generation, from Pinnacle West employees
27 who are bidding the PWEC facilities, is a work in progress and remains to be developed through this
28

1 process, and that Pinnacle West is in the process of providing some physical separation between areas
2 in Pinnacle West Marketing and Trading (“M&T”) that deal only with APS and areas that deal with
3 other aspects of M&T operations. (Tr. at 608-609) APS also testified at the hearing that the
4 standards of conduct it anticipated working through with Staff would have a separation of functions
5 at Pinnacle West between those people who are responsible for commitment of dispatch and
6 management of the APS resources, and those people who are responsible for those same functions for
7 non-APS assets. (Tr. at 606) In its Reply Brief, APS stated that it is identifying the team of
8 employees that will conduct the solicitation and will take steps to ensure that they do not share
9 inappropriate information with employees of APS affiliates who may be directly involved in the
10 preparation of a bid in the solicitation process.
11

12 **4. Equal Treatment of PWEC and other bidders**

13 PGR takes the position that if an incumbent utility’s affiliate will bid in a Commission
14 mandated competitive solicitation, the incumbent utility must treat the affiliated and non-affiliated
15 generation equally in all respects. PGR believes that this equal treatment should apply to capacity,
16 gas, or electric transmission, and that if APS’ affiliate is to bid in the solicitation, then APS must
17 make gas capacity held by APS for the benefit of Arizona consumers available to any merchant
18 bidder on the same terms as would be available to APS’ affiliate. Thus, before any APS affiliate
19 could bid with gas capacity belonging to APS, that gas capacity would be made available to all
20 bidders on equal terms, such as through a tolling arrangement. Harquahala also believes that the
21 Commission should require APS to offer to all the merchants any El Paso gas capacity either it or
22 Pinnacle West has.
23
24

25 APS responded that APS and PWEC are co-shippers on a transportation service agreement
26 (“TSA”) with El Paso Natural Gas, each with their own individual rights, and the determination of
27 those respective rights is currently before the FERC. (Tr. at 615) APS also stated that, although it
28

1 does not believe it is required to offer its own gas transportation capacity to anyone just because they
2 want it (Tr. at 614), APS does believe that the TSA allows it to use its own gas capacity through a
3 tolling arrangement with any generator. (Tr. at 616-618, *see also* Exh. PGR-1)

4 **5. Discussion/Resolution**

5 We agree that the standards of conduct developed in this proceeding will be material to the
6 Code of Conduct hearing which shall be scheduled to take place as soon as practicable after the initial
7 solicitation, and that the experience of the initial solicitation will provide insight to the requirements
8 of a working Code of Conduct in an environment that includes the availability to regulated utilities of
9 both affiliated and non-affiliated generation resources. We will therefore direct Staff, following
10 completion of the initial solicitation, to file reports in these dockets on the Codes of Conduct
11 previously filed by APS and TEP. The Staff Reports should include an analysis of the standards of
12 conduct developed in this proceeding, their applicability to the respective Codes of Conduct filed by
13 TEP and APS, and recommendations regarding their incorporation into the Codes of Conduct.
14 Hearings will be scheduled on the Codes of Conduct following the filing of those Staff Reports.
15

16 We agree with Staff that the oversight provided by the Independent Monitor, as well as Staff
17 participation in the solicitation process, will aid in assuring that the utilities act in the best interests of
18 customers, while furthering the Commission's goal of encouraging the development of a vibrant
19 wholesale generation market in Arizona. We also acknowledge and appreciate APS' assurances that
20 it is identifying the team of employees that will conduct the solicitation and that it will take steps to
21 ensure that they do not share inappropriate information with employees of APS affiliates who may be
22 directly involved in the preparation of a bid in the solicitation process. The standards of conduct
23 should go far toward alleviating the concerns of the merchants who face competition from APS'
24 affiliate in the APS solicitation process. However, the content of the standards of conduct are not in
25 the record of this proceeding. In addition, we have not completed our review of APS' revised Code
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1 of Conduct, which APS filed as required. We therefore find it necessary to set forth some guidelines
2 to clarify the Commission's position that no exercise of affiliate preferences will be tolerated in the
3 solicitation process.

4 We note that the Staff Proposed Solicitation Process provides for the establishment by the
5 utility of a system for logging all contacts between utility personnel and bidders and potential
6 bidders. (*See* Exh. S-1 at 20) We will require that APS keep detailed records of any and all contacts
7 with all non-APS entities, including but not limited to M&T, PWEC and Pinnacle West, regarding
8 this initial and subsequent solicitations up through the time that the procurement process is complete.
9 These records shall be subject to the same maintenance and availability requirements as those
10 described on pages 26 and 27 of the Staff Report.

12 In addition, the record in this proceeding supports a requirement that APS' parent and
13 affiliates, including but not limited to M&T, PWEC and Pinnacle West, who may be involved in the
14 preparation of a bid in the solicitation process shall not have contact with employees that will conduct
15 the solicitation. We do not wish to harm APS customers by depriving APS of access to needed
16 expertise provided by Pinnacle West "shared services," such as consulting legal counsel or in-house
17 environmental experts, the examples provided by APS in its Reply Brief. However, we see no reason
18 to allow APS' parent and affiliates, including but not limited to M&T, PWEC and Pinnacle West,
19 access to such expertise if such access could provide even an appearance of impropriety in the
20 solicitation process. We will therefore require that for the purposes of the solicitation and
21 procurement, APS shall prohibit personnel who provide advice to APS in the solicitation process
22 from communicating with personnel working for APS' parent or affiliates who may be involved in
23 the preparation of a bid in the solicitation process, concerning any business matter related to APS'
24 parent and affiliates pertaining to the Track B solicitation. Notwithstanding any other provision of
25 this Opinion and Order to the contrary, nothing herein shall be construed as prohibiting APS,
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1 Pinnacle West, or PWEC officers and directors from providing corporate oversight, support and
2 governance to their employees so long as such activities do not favor PWEC in Track B or provide
3 PWEC with confidential bidding information during the Track B procurement that is not available to
4 all other Track B bidders; nor prohibiting APS or Pinnacle West employees from communicating
5 with PWEC employees about non-Track B matters. If APS affiliates, including but not limited to
6 M&T, PWEC and Pinnacle West, require access to expertise that is dedicated to APS in the
7 procurement process, they can obtain such expertise elsewhere, at their own expense.
8

9 The time remaining for the initial solicitation process does not allow for a hearing on the
10 Codes of Conduct as requested by Reliant. We believe that the requirements for standards of conduct
11 set forth in the Staff Proposed Solicitation Process, along with the additional requirements stated
12 above, should provide adequate safeguards to address the merchants' concerns.

13 We believe that a requirement that an incumbent utility treat affiliated generation equally in
14 all respects with non-affiliated generation in the solicitation process would logically extend to any
15 contractual arrangements associated with the bidding and procurement process that the incumbent
16 utility enters into with any affiliated entity involved in the solicitation and procurement process,
17 including, but not limited to, access to gas capacity or transportation under APS' contract with El
18 Paso Natural Gas Company. In the interest of a fair, open and transparent solicitation process,
19 affiliate preferences will not be permitted in any regard.
20

21 While we adopt these guidelines, they do not constitute an all-inclusive list of the restrictions
22 on the type of activities that APS and its affiliates must prevent. We want to make clear that any
23 preferential or discriminatory activity by APS, its parent or affiliates that interferes with a fair,
24 unbiased solicitation process, whether specifically delineated or not in the standards of conduct, the
25 Code of Conduct, or this Decision, will not be tolerated, and that we will closely scrutinize the
26 solicitation process for signs of any such abuse. Notwithstanding any other provision of this Opinion
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1 and Order to the contrary, nothing herein shall be construed as prohibiting APS, Pinnacle West, or
2 PWEC officers and directors from providing corporate oversight, support and governance to their
3 employees so long as such activities do not favor PWEC in Track B or provide PWEC with
4 confidential bidding information during the Track B procurement that is not available to all other
5 Track B bidders; nor prohibiting APS or Pinnacle West employees from communicating with PWEC
6 employees about non-Track B matters.

7
8 **B. TEP**

9 Because TEP does not have an affiliate that will bid in the upcoming competitive solicitation
10 process, TEP proposed that its Wholesale Marketing department be allowed to conduct the
11 competitive solicitation. (Exh. TEP-1 at 8-9 (Testimony of David Hutchens regarding Needs
12 Assessment and Procurement Proposal), Exh TEP-2 at 5-6, 12 (Direct Testimony of David
13 Hutchens)) TEP requested that the Commission waive the applicability of Section IV.C, paragraph 1,
14 lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing
15 department to be involved in the solicitation process. (Exh. TEP-2 at 12) Staff had no objection to
16 TEP's request for a waiver of this paragraph of the Staff Report's Solicitation Process for the initial
17 solicitation (Tr. at 89-90), and no other party to the proceeding objected to TEP's request. TEP
18 acknowledged that if at some point in the future there is a TEP affiliate that could participate in a
19 competitive solicitation on TEP contestable load, then appropriate steps should be taken to address
20 the specific affiliate concerns. Based on this acknowledgement, and on the fact that TEP does not
21 have an affiliate that will bid in the upcoming competitive solicitation process, we find that it is
22 reasonable to grant TEP's request to allow TEP's Wholesale Marketing department to be involved in
23 the solicitation process.
24
25

26 ...

27 ...

1 **C. Protocol for Short-Term Energy Procurement by APS and TEP**

2 Harquahala recommended that in order to limit any advantage PWEC might receive from
3 APS, that a protocol be adopted to guide APS' procurement of short-term energy. APS has stated
4 that it increasingly uses "blind" procurement techniques for short-term economy purchases. (Exh.
5 APS-5 at 10-13 (Rebuttal Testimony of Thomas J. Carlson)) We believe that it would be wise for
6 APS to adopt the practice of using such "blind" procurement techniques, such as electronic auctions,
7 electronic trading platforms or independent brokers, for all its short term purchases with the
8 exception of emergency purchases. We will require APS to file, for Commission approval, a draft
9 protocol adopting such a practice.
10

11 TEP does not currently have an affiliate offering power on the wholesale market. However, if
12 it does in the future, TEP should also adopt the practice of using "blind" procurement techniques,
13 such as electronic auctions, electronic trading platforms or independent brokers, for all its short term
14 purchases with the exception of emergency purchases. We will therefore require that, if a
15 competitive affiliate of TEP will offer power on the wholesale market, TEP shall file, for
16 Commission approval, 60 days prior to the commencement of such offer, a draft protocol adopting
17 such a practice.
18

19 **V. PRUDENCY REVIEW**

20 The Staff Proposed Solicitation Process provides that after the completion of each utility's
21 initial solicitation, Staff will commence a review of the utility's power supply portfolio to examine
22 the prudence of that utility's planning and procurement practices, and to determine the effectiveness
23 and efficiency of the solicitation process employed.
24

25 APS proposes that after bid evaluation is complete, provisional contracts would be awarded to
26 bidders, and that the Commission should either affirmatively approve such contracts within 15 days
27 or alternatively, deem them as being approved if the Independent Monitor's report concludes that the
28

1 solicitation was effective and fair. (Exh. APS-3 at 6-7 (Direct Testimony of Steven M. Wheeler))
2 APS proposes that in either event, Commission approval should constitute a finding that the utility
3 acted prudently and reasonably in entering into the approved contracts, both individually and
4 collectively. (*Id.* at 7) APS proposes that such a finding should also provide for full and timely cost
5 recovery, either through a purchase power adjustment mechanism or some similar procedure. (*Id.*)

6 TEP believes that the Commission approval process and cost-recovery mechanism for
7 purchases made under the solicitation process should be addressed in this proceeding. (Exh. TEP-2 at
8 10 (Direct Testimony of David Hutchens)) TEP states that it is critical that the utility knows what the
9 approval process will be at the beginning of the process because it will affect procurement decisions
10 and other issues in the proceeding, and the process should provide a specific timeline for contract
11 approval and the ability of the utility to reject accepted bids if the Commission does not find those
12 contracts reasonable and prudent. (*Id.* at 11)

14 Staff believes that the requested expedited contract approval would not be in the public
15 interest and is unnecessary and inappropriate. (Exh. S-2 at 2 (Direct Testimony of Ernest G.
16 Johnson)) Staff states that while it is committed to assisting the Commission in its efforts to
17 transition to and facilitate a robustly competitive wholesale electric market in Arizona, that this is not
18 the time to adopt an expedited approval process, and further, that expedited approval is not a
19 necessary component to facilitating the envisioned robustly competitive wholesale electric market.
20 (*Id.* at 2-3) Staff believes that in light of the oversupply of generation that currently exists in
21 Arizona, in-state generators will be compelled to bid for contestable load, and that out-of-state
22 suppliers may also find the solicitation process amenable and contestable load desirable, such that
23 expedited approval is not required to attract bidders at this time. (*Id.* at 3) Staff believes that
24 granting expedited approval would shift the risk of cost recovery away from the utility onto
25 consumers. (*See Id.*)
26
27
28

1 Staff states that ultimately, the Commission must evaluate whether the utility was prudent in
2 its selection of its portfolio as a whole and whether the utility solicited the right products (Tr. at 78-
3 79, 107-108), and argues that neither of these factors is addressed by an expedited approval process
4 that assumes the prudence of any contract that results from a competitive bid.

5 RUCO generally shares Staff's concerns about prematurely declaring contracts prudent, but
6 states that the traditional IRP process, which it advocates, is sufficient to assure the Commission that
7 the utility has engaged in prudent planning. (Exh. RUCO-1 at 33-34 (Direct Testimony of Dr.
8 Richard A. Rosen), RUCO-2 at 7-8 (Rebuttal Testimony of Dr. Richard A. Rosen)) Even if an IRP
9 process would assure prudent planning, however, RUCO states that implementation of the plan
10 should still be subject to prudence review only in a proceeding that determines final cost recovery.
11

12 Sempra and SWPG generally agree with the balance that Staff's position strikes between
13 allowing the utility to conduct the competitive solicitation and make the final bid selections, and
14 providing for continuing Commission oversight and subsequent prudence review. They believe that
15 because the utility must implement and live with the results of a given power procurement decision, it
16 is appropriate that the utility perform a significant role in the making of such decision. Sempra and
17 SWPG believe that the utility should be held accountable for the results of its decision and its
18 compliance or lack of compliance with the Commission-approved competitive procurement process,
19 and that the contemplated subsequent prudence review is the appropriate setting for such
20 accountability to be determined.
21

22 Reliant asserts that the role and responsibilities of the Independent Monitor provide sufficient
23 safeguards in the solicitation process to allow the Commission to make a prudence determination of
24 the solicitation process, products, and outcome within 5 to 30 days. Reliant argues that with
25 extensive participation by Staff, the Independent Monitor, and other participants throughout this
26 process, the Commission will already have access to the knowledge of all facets of the solicitation by
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1 the time the procurement takes place. Reliant cites regulatory uncertainty, and higher bids, as a
2 drawback to the Commission's failure to provide a quick prudency review of contracts.

3 AUIA disagrees with Staff's position regarding the prudency review of utilities' procurement
4 decisions, and argues that the Commission should adopt an expedited approval process. AUIA also
5 argues, however, in support of its position that the utilities should be allowed to choose their manner
6 of solicitation, that the Commission should heed the Staff's imperative that the utility should be left
7 with the ultimate decision-making authority regarding its needs and the ultimate responsibility to act
8 prudently. (AUIA Br. at 9, citing Exh. S-2 at 4 (Rebuttal Testimony of Ernest G. Johnson))

10 APS asserted that Commission and Staff assurance of cost recovery is especially appropriate
11 given that the Commission has mandated this procurement through a formal process and on a
12 schedule not entirely of the Company's choosing, and which is in contrast to the flexibility allowed in
13 the current version of A.A.C. R14-2-1606(B). (Exh. APS-3 at 7 (Direct Testimony of Steven M.
14 Wheeler)) We disagree with the premises of that assertion. Firstly, we disagree with APS' argument
15 that the Track B solicitation process restricts the manner by which APS procures power. We strongly
16 agree with Staff, and AUIA, that the utility should have decision-making authority regarding its
17 needs and the responsibility to act prudently, and our Decision in this matter adopts Staff's wise
18 recommendation to leave the responsibility and choice of procurement squarely in the lap of the
19 utility. Secondly, the Track B solicitation process is, rather than a "mandated procurement," the
20 means by which this Commission is dealing with the fact that leading up to our determination, in
21 Decision No. 65154, to stay the requirements of A.A.C. R14-2-1606(B)²⁴, APS had chosen not to
22 commence the competitive bid process that rule required, but had chosen instead to propose a
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25 . . .

26
27 ²⁴ A.A.C. R14-2-1606(B) provides: After January 1, 2001, power purchased by an investor owned Utility
28 Distribution Company for Standard Offer Service shall be acquired from the competitive market through prudent, arm's
length transactions, and with at least 50% through a competitive bid process.

1 variance from the rule in order to allow it to enter into a purchase power agreement with its affiliate
2 PWEC.

3 To the extent that the utilities need guidance as to review of their procurement decisions,
4 among the issues the Commission may look to are: 1) whether the process was fair and non-
5 discriminatory, or whether it favored an affiliate; 2) evidence to support a determination that the
6 decision was in the best interests of the ratepayers; and 3) whether the utility's decision facilitated the
7 development of a competitive wholesale generation market in Arizona.

8
9 We believe that the solicitation process outlined in the Staff Report and clarified in this
10 Decision can encourage the development of a robust wholesale market while providing benefits to
11 Arizona consumers, without the Commission's direct involvement through the requested expedited
12 prudence review, in the solicitation process. We agree with Staff that expedited approval of contracts
13 is not necessary for the protection of either the utilities or the merchants, and further, that such
14 expedited approval would pose a substantial risk to consumers. The "Price to Beat" concept (page
15 24, line 2 through page 26, line 14 of the Staff Report attached hereto as Exhibit A) was abandoned at
16 hearing and the expedited approval of procurement contracts entered as a result of the competitive
17 solicitation is not necessary at this time for the protection of either the utilities or the merchants and
18 neither is adopted by the Commission. We recognize that the utilities have developed great expertise
19 in energy procurement decisions under the vertically-integrated utility model, and believe that they
20 should utilize that expertise in the solicitation process that has been developed in this proceeding in
21 order to take advantage of the existence of the new supply of competitive generation resources.
22

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VI. THE STAFF REPORT AS GUIDE FOR THE SOLICITATION PROCESS

We find that the record in this proceeding supports Commission adoption of the section of the Staff Report entitled Detailed Staff Proposed Solicitation Process, Exh. S-1, pages 6-27.²⁵ In our discussion, we have addressed certain issues on which the parties were unable to reach consensus in the workshop process. The Detailed Staff Proposed Solicitation Process shall be interpreted in keeping with our resolution of those issues as set forth in our discussion herein.

The target dates enumerated in the Staff solicitation time line provided at page 29 of the Staff Report may be adjusted by the utilities, after consultation with the Staff and the Independent Monitor, to accommodate both the issuance of this Order and to provide more time for the concurrent evaluation of bids, including those that do not conform to the RFPs issued by APS or TEP. However, any contracts for service from this initial Track B solicitation shall entered on or before June 1, 2003.

The Commission notes that the Detailed Staff Proposed Solicitation Process requires that each bidder must agree to permit the Commission Staff to inspect any generating facility the bidder owns or controls from which it proposes to provide capacity or energy to any Arizona utility pursuant to any contract awarded as a result of this solicitation. This important provision will aid the Commission in ensuring that any claimed outages by a successful bidder are legitimate and not used as a tool for market manipulation. The Commission also notes that additional safeguards against market manipulation in Arizona are necessary to protect the fundamental fairness of the solicitation process and the public interest at stake for Arizona electric consumers. Therefore, the Commission requires that in addition, each bidder shall provide written assurance as a guarantee that it will not engage in unlawful market manipulation in either the solicitation process or in the carrying out of its

²⁵ Reliant has requested that the Commission adopt, as part of Appendix One to the Staff Report, its amended description of the Texas competitive process to more accurately reflect the situation in Texas. As Reliant notes, its suggested change to the Staff Report was not opposed by any party. While the inclusion in the Staff Report of Appendix One was generally helpful in providing a broad overview of competitive solicitation for wholesale generation supply in selected states, we do not find it necessary to adopt or endorse Appendix One. Therefore, we will note Reliant's request, but we find that it is unnecessary to adopt Reliant's amended description for purposes of our Decision in this matter.

1 contract if it is a successful bidder. Likewise, similar written assurances shall also be required of the
2 bidding entities' chief financial officers that will serve as guarantees that the bidding entity is not
3 engaging in and shall not engage in any unlawful market manipulation in the Western
4 Interconnection wholesale market of which Arizona is a part. Specifically, the written assurance
5 shall provide that allegations of a bidder's failure to abide by the written assurances/guarantees will
6 constitute grounds for the institution of Commission proceedings to determine whether the bidder or
7 its officers are in violation of the assurances/guarantees. If the assurances/guarantees against market
8 manipulation are determined to have been violated, the Commission in its discretion shall be entitled
9 to take appropriate action, after notice and an opportunity for hearing, including but not limited to
10 penalties, fines, rescission of the contract and/or exclusion from future solicitation processes. To
11 carry out this requirement, Staff is directed to include these provisions as part of the solicitation
12 process.
13

14 **VII. REVIEW OF SOLICITATION PROCESS**

15 The Staff Proposed Solicitation Process adopted herein provides that after the completion of
16 each utility's initial solicitation, Staff will commence a review of the utility's power supply portfolio
17 to examine the prudence of that utility's planning and procurement practices, and to determine the
18 effectiveness and efficiency of the solicitation process employed.
19

20 The Staff Proposed Solicitation Process adopted herein also contemplates that Staff will
21 commence a proceeding to review the solicitation process, address the planning for future
22 solicitations, and recommend such changes to the process as may be appropriate. Sempra and SWPG
23 recommended that a Decision in this matter expressly indicate that all future competitive solicitations
24 will be conducted with the same openness and opportunity to participate as have characterized the
25 current Track B proceeding, and that merchant plant competitors and other interested persons who
26 were not in a position to participate in the initial solicitation in 2003 should not be precluded from
27
28

1 participation in subsequent competitive procurements. We see no reason why future competitive
 2 solicitations would not be as open as the initial solicitation, and therefore see no need to make such
 3 an explicit finding here. However, if Sempra and SWPG wish to formally raise that issue, they may
 4 raise it in the solicitation process review proceeding described above.

5 We will require that Staff file a report in these dockets informing the Commission of its
 6 progress in the contemplated reviews described above and at page 27 of the Staff Report, Exh. S-1.

7 **VIII. AISA**

8 The issue of the continuation of the AISA under the Commission's rules and the
 9 Commission's decisions approving the APS and TEP Settlement Agreements should be further
 10 examined. Staff is directed to file an update to its November 2001 Staff Report that considers the
 11 Commission's recent decisions in these consolidated dockets and makes appropriate
 12 recommendations in the AISA Docket No. E00000A-01-0630 on or before May 30, 2003. The
 13 Hearing Division is directed to notice a proceeding in compliance with A.R.S. § 40-252, with notice
 14 and an opportunity to be heard to the affected parties concerning the continuation of the AISA, as
 15 timely as possible upon the filing of the updated Staff Report.
 16

17 * * * * *

18 Having considered the entire record herein and being fully advised in the premises, the
 19 Commission finds, concludes, and orders that:
 20

21 **FINDINGS OF FACT**

22 1. On October 18, 2001, Arizona Public Service Company filed a Request for a Partial
 23 Variance to A.A.C. R14-2-1606(B) and for Approval of a Purchase Power Agreement.

24 2. By Procedural Order issued January 22, 2002, the Commission opened this generic
 25 docket on electric restructuring (Docket No. E-00000A-02-0051).

26 3. On January 28, 2002, Tucson Electric Power Company filed a Request for Variance
 27 (Docket No. E-01933A-02-0069).

28 4. Intervention was granted to numerous parties.

1 5. On March 19, 2002, Panda Gila River, L.P. filed a Request for Order to Show Cause.

2 6. On March 22, 2002, Staff filed its Staff Report in the generic docket.

3 7. On April 25, 2002, the Commission held a Special Open Meeting at which the
4 Commission directed that certain issues be addressed in the Generic Docket.

5 8. By Procedural Order issued on May 2, 2002, a hearing was set on the issues identified
6 by the Commission as “Track A” issues. Track B, Competitive Procurement, was also established.

7 9. The May 2, 2002 Procedural Order also directed that Track B proceed concurrently
8 with Track A, and instructed interested parties to file by May 13, 2002, a list of proposed issues for
9 consideration, and a procedural timetable (including comment periods) for the Track B issues.

10 10. On May 13, 2002, TEP, APS, the Arizona Competitive Power Alliance, RUCO, and
11 Staff filed Track B proposals in compliance with the May 2, 2002 Procedural Order. Staff indicated
12 in its filing that it anticipated awarding a contract to an Independent Evaluator on or around July 8,
13 2002.

14 11. On May 31, 2002, Staff filed a list of issues for comment of the other parties.

15 12. On June 20, 2002, based on the proposals submitted on May 13, 2002, the First
16 Procedural Order on Track B Issues established a procedural schedule that included workshops, as
17 proposed by Staff, on July 24 and 25, 2002. The First Procedural Order stated that the balance of the
18 procedural schedule would be dependent upon the Commission’s Decision on the Track A issues, the
19 consensus reached by the parties during the workshops or otherwise, and whether a hearing on any
20 Track B issues became necessary. The First Procedural Order set a deadline for the parties to
21 respond to Staff’s May 31, 2002 list of issues by July 1, 2002, which response was to include any
22 competitive solicitation issues not addressed in Staff’s May 31, 2002 filing, and also set a deadline of
23 July 17, 2002, for Staff and the Independent Evaluator to file a list of issues to be addressed at the
24 July 24 and 25, 2002 workshops.

25 13. Hearings were held on the Track A issues during the last two weeks of June, 2002, and
26 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its
27 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in
28 Track B to develop a competitive solicitation process that can begin by March 1, 2003.

1 14. The parties held an additional Track B workshop on August 13 and 14, 2002.

2 15. On September 16, 2002, Staff filed a Request for Procedural Order asking that a
3 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to
4 be held on September 26 and 27, 2002.

5 16. APS and PGR filed responses to Staff's request indicating their agreement that a
6 hearing would likely be necessary to achieve a resolution of the Track B issues. While APS agreed
7 with the procedural schedule proposed by Staff in its Request, PGR requested a scheduling
8 conference so that all parties might comment on dates to be included in any procedural order and on
9 issues to be addressed at the hearing.

10 17. The Second Procedural Order on Track B Issues was issued on September 24, 2002
11 and required the parties to file, by October 1, 2002, their proposed schedules for the conduct of a
12 hearing to be held following the third workshop, and a list of the specific issues the parties believed
13 remained to be addressed at the hearing.

14 18. A procedural conference was held as scheduled on October 2, 2002.

15 19. The Third Procedural Order on Track B Issues, issued on October 9, 2002, required
16 APS and TEP to file a needs assessment and procurement proposal, sufficient to inform the
17 Commission in its determination of the minimum amount of power, the timing, and the form of
18 procurement as required by Decision No. 65154.

19 20. Public notice of the proceedings on the Track B issues was published in newspapers of
20 general circulation in the APS and TEP service areas statewide between November 4 and 6, 2002.
21 No further intervention requests were filed following the publication.

22 21. The hearing was held as scheduled. Mr. Bob Liden of Stirling Energy Systems
23 provided public comment at the hearing. No other parties appeared to provide public comment on the
24 Track B issues. Witnesses testified on behalf of Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra,
25 WMGF, the LAW Fund and RUCO.

26 22. AUIA, PPL, and SWPG did not present witnesses, but participated in the hearing.

27 23. APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW
28 Fund, RUCO and Staff filed Initial Briefs on December 18, 2002.

1 24. APS, TEP, Harquahala, PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund,
2 RUCO and Staff filed Reply Briefs on December 31, 2002.

3 25. The solicitation process developed in the workshop process by the parties, as set forth
4 in the Detailed Staff Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002
5 Staff Report, is a necessary step in the Commission's goal of encouraging the development of a
6 competitive wholesale generation market in Arizona while protecting Arizona's ratepayers, and
7 should be adopted, as modified by the discussions and Findings of Fact herein. That section of the
8 October 25, 2002 Staff Report is attached hereto as Exhibit A.

9 26. The Detailed Staff Proposed Solicitation Process requires that each bidder must agree
10 to permit the Commission Staff to inspect any generating facility the bidder owns or controls from
11 which it proposes to provide capacity or energy to any Arizona utility pursuant to any contract
12 awarded as a result of this solicitation. This important provision will aid the Commission in ensuring
13 that any claimed outages by a successful bidder are legitimate and not used as a tool for market
14 manipulation. Additional safeguards against market manipulation in Arizona are necessary to protect
15 the fundamental fairness of the solicitation process and the public interest at stake for Arizona electric
16 consumers. Therefore, the Commission requires that in addition, each bidder shall provide written
17 assurance as a guarantee that it will not engage in unlawful market manipulation in either the
18 solicitation process or in the carrying out of its contract if it is a successful bidder. Likewise, similar
19 written assurances shall also be required of the bidding entities' chief financial officers that will serve
20 as guarantees that the bidding entity is not engaging in and shall not engage in any unlawful market
21 manipulation in the Western Interconnection wholesale market of which Arizona is a part.
22 Specifically, the written assurance shall provide that allegations of a bidder's failure to abide by the
23 written assurances/guarantees will constitute grounds for the institution of Commission proceedings
24 to determine whether the bidder or its officers are in violation of the assurances/guarantees. If the
25 assurances/guarantees against market manipulation are determined to have been violated, the
26 Commission in its discretion shall be entitled to take appropriate action, after notice and an
27 opportunity for hearing, including but not limited to penalties, fines, rescission of the contract and/or
28 exclusion from future solicitation processes. Staff is directed to include these provisions as part of

1 the solicitation process.

2 27. APS and TEP are responsible for providing for the continuing need of their ratepayers
3 to maintain a reliable supply of electricity at reasonable rates.

4 28. The issues that the parties were unable to reach a consensus agreement on in the Track
5 B workshop processes, and which therefore require a Commission resolution, are as follows: 1) the
6 solicitation and bid process to be approved, including whether to institute an integrated resource
7 planning process; 2) the amount of capacity and energy to be solicited; 3) the bid evaluation method
8 to be approved, including whether APS and TEP are required to accept any bids; 4) affiliate
9 participation in the bid process; 5) the Commission's prudence review of contracts resulting from the
10 bid process; and 6) the direction of future proceedings, including DSM and environmental risk
11 mitigation programs.

12 29. Decision No. 65154 set the minimum baseline amount of power that APS and TEP
13 would be required to acquire in the competitive solicitation, but left for this Track B proceeding the
14 determination of the actual minimum amount of power to be acquired, the timing of the power
15 procurement, and the form of the procurement.

16 30. Decision No. 65154 does not limit the amount of power that the Commission may
17 require APS and TEP to solicit in the competitive solicitation.

18 31. APS and TEP shall test the market in this solicitation, beyond the required power that
19 cannot be produced from their respective existing assets or existing contracts, which will also allow
20 APS and TEP to evaluate whether reliable generation is available at a lower cost than that produced
21 by their own existing assets, or at a comparable level of cost. The amount by which APS and TEP
22 must test the market in this competitive solicitation, and which will include required power that
23 cannot be produced from their respective existing assets or existing contracts, is their contestable
24 load. While this record has not developed sufficiently quantitative evaluation criteria for measuring
25 and weighing environmental impacts, we are cognizant of the incontrovertible fact that natural gas-
26 fired, combined cycle, combustion turbine generation emits far fewer pollutants than oil-fired or coal-
27 fired generation. That said, it is also true that "location matters," and relatively higher polluting
28 generation far from highly populated airsheds may be preferable to a natural gas-fired, combined

1 cycle, combustion turbine plant in a highly populated airshed. These contradictions make it
2 impossible for us to set a firm benchmark in this Order. Therefore, we will require the utilities to
3 prepare an environmental analysis for this Commission and submit it to this docket within 90 days of
4 completion of the solicitation. That analysis will detail the environmental effects of the utilities'
5 power supply portfolio resulting from this solicitation against a benchmark analysis of the
6 environmental impacts of the utilities' past five years of operations.

7 32. If the competitive solicitation for contestable load yields bids for capacity or energy
8 beyond required power that cannot be produced from APS' and TEP's respective existing assets or
9 existing contracts, and if APS and TEP determine, after serious economic and technical analysis of all
10 bids, including long-term and short-term bids, that the offered capacity or energy would serve their
11 customers more economically than their existing assets, then APS and TEP should make
12 procurements accordingly, keeping in mind that the goal of the competitive solicitation is to provide
13 ratepayers with reliable power at the lowest cost. To resolve our inability to properly assess and
14 weigh environmental factors as noted above and to ensure that future competitive solicitations are
15 able to accurately and reliably assess the environmental impacts of solicitation decisions, we direct
16 Staff to begin a series of environmental risk management workshops, commencing in the summer, in
17 which Staff and the parties shall develop a set of criteria that are knowable and measurable and which
18 can be used in future solicitations to weigh the environmental impact of offers received in the
19 solicitation process.

20 33. Transmission constraints currently limit the capacity and energy that can be delivered
21 from particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and
22 may give rise to RMR requirements inside those load pockets.

23 34. Inclusion of RMR in contestable load should increase the benefits to be derived from
24 competitive bidding by providing a market response reference regarding the relative economic and
25 environmental merits of competitive generation solutions to Arizona's load pocket problems.

26 35. All generation that can reliably deliver energy into load pockets, under the RMR
27 contestability conditions set forth in Findings of Fact No. 36 below, shall be allowed to compete in a
28 fair and open manner to supply energy and capacity to both APS and TEP in the solicitation process.

1 36. RMR capacity and energy should be contestable under the following conditions: 1) if
2 non-utility owned or non-rate based generation exists locally; 2) if remote generation has access to
3 non-APS or non-TEP firm transmission capacity that would enable delivery to the local area; or 3) if
4 owners of remote generation offer to finance transmission improvements to remedy the transmission
5 constraint.

6 37. APS, Salt River Project, TEP and the Western Area Power Administration are
7 currently participating in RMR studies for the years 2003-2005 to be filed by APS and TEP with the
8 Commission by January 31, 2003, and which are to include the identification of RMR hours, capacity
9 and energy.

10 38. It is reasonable for Staff and the Independent Evaluator to review the January, 2003
11 RMR study results, and comments to those results, and to thereafter make necessary revisions to the
12 RMR amounts appearing in Staff's contestable load estimates during the Pre-Solicitation process set
13 forth in the Staff Report.

14 39. The utilities shall evaluate RMR and non-RMR bids concurrently, in order to
15 determine their best least-cost portfolio.

16 40. The protocols applicable to RMR bids and contract management shall be the AISA or
17 WestConnect protocols, whichever are in effect on a given date.

18 41. APS shall solicit capacity in amounts conforming to, at a minimum, Staff's estimates
19 as set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
20 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
21 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
22 Pre-Solicitation process set forth in the Staff Report.

23 42. TEP shall solicit capacity in amounts conforming, at a minimum, to Staff's estimates
24 as set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
25 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
26 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
27 Pre-Solicitation process set forth in the Staff Report.

28 43. APS shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as

1 set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
2 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
3 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
4 Pre-Solicitation process set forth in the Staff Report.

5 44. TEP shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as
6 set forth in its December 18, 2002 revision to Exh. S-5, attached hereto as Exhibit B, with the
7 addition of the necessary RMR amounts as determined by Staff and the Independent Evaluator
8 following their receipt and review of comments to the January, 2003 RMR Study Results, during the
9 Pre-Solicitation process set forth in the Staff Report.

10 45. The utilities shall use least cost planning principles to develop their overall portfolios.
11 In determining the appropriate resource portfolio in the best interests of their customers, APS and
12 TEP shall seriously consider a well-balanced mixture of contracts, including long-term contracts, in
13 order to protect ratepayers from future upswings in power prices.

14 46. APS and TEP shall have the right to reject all bids if the bids do not reasonably meet
15 the needs of the utility and its customers, after sound economic and deliverability analysis of all bids
16 received, including long- and short-term bids. The utilities' goal should be to obtain for their
17 customers the least-cost mix of reliable power over the long term, while being mindful of the air
18 quality and water issues effects of their procurement decisions, as well as whether their procurement
19 decisions will further this Commission's goal of encouraging the development of a competitively
20 robust wholesale generation market in Arizona. While we are not requiring APS and TEP to accept
21 bids in the solicitation process that are unreasonable, uneconomical, or unreliable, APS and TEP
22 should be on notice that the Commission will closely scrutinize the offered bids and the utilities'
23 procurement decisions based on those bids for conformity with those goals. If the utility accepts no
24 bids, the utility shall notify the Commission by filing a detailed written explanation within 72 hours
25 after its decision. The Commission may take whatever action it deems appropriate at that time.

26 47. APS buys power on the wholesale market, and its affiliate offers power on the
27 wholesale market.

28 48. Merchant generators have expressed concern that allowing Pinnacle West to share

1 services with APS related to system dispatch, risk management or contract management would
2 provide APS' competitive affiliates access to information that would impermissibly create an unfair
3 competitive advantage to the affiliate.

4 49. APS stated that it is working with Staff to establish the standards of conduct required
5 by the Staff Proposed Solicitation Process, and is identifying the team of employees that will conduct
6 the solicitation and will take steps to ensure that they do not share inappropriate information with
7 employees of APS affiliates who may be directly involved in the preparation of a bid in the
8 solicitation process.

9 50. While we acknowledge and appreciate APS' efforts regarding standards of conduct,
10 the fact that the standards of conduct are not a part of the record in this proceeding necessitate the
11 establishment of guidelines to clarify the Commission's position that no exercise of affiliate
12 preferences will be tolerated in the solicitation process.

13 51. APS shall treat non-affiliated generation equally in all respects with affiliated
14 generation in the solicitation process. This requirement extends to any contractual arrangements
15 associated with the bidding and procurement process that APS enters into with any affiliated entity
16 involved in the solicitation and procurement process, including, but not limited to, access to gas
17 capacity or transportation under APS' contract with El Paso Natural Gas Company.

18 52. APS shall keep detailed records of any and all contacts with all non-APS entities,
19 including employees of and contractors for its parent and all affiliates, including but not limited to
20 M&T, PWEC and Pinnacle West, regarding this initial solicitation, and subsequent solicitations, up
21 through the time that the procurement process is complete. These records shall be subject to the same
22 maintenance and availability requirements as those described on pages 26 and 27 of the Staff Report.

23 53. Employees of and contractors for APS's parent and affiliates, including but not limited
24 to M&T, PWEC and Pinnacle West, who may be involved in the preparation of a bid in the
25 solicitation process, shall not have contact with employees that will conduct the solicitation,
26 concerning any business matter related to APS' parent or affiliates pertaining to the Track B
27 solicitation.

28 54. For the purposes of the solicitation and procurement, APS shall prohibit all personnel

1 who provide advice to APS in the solicitation process from communicating with any personnel
2 working for or contracted to APS's parent or affiliates who may be involved in the preparation of a
3 bid in the solicitation process, concerning any business matter related to APS' parent or affiliates
4 pertaining to the Track B solicitation. Notwithstanding any other provision of this Opinion and Order
5 to the contrary, nothing herein shall be construed as prohibiting APS, Pinnacle West, or PWEC
6 officers and directors from providing corporate oversight, support and governance to their employees
7 so long as such activities do not favor PWEC in Track B or provide PWEC with confidential bidding
8 information during the Track B procurement that is not available to all other Track B bidders; nor
9 prohibiting APS or Pinnacle West employees from communicating with PWEC employees about
10 non-Track B matters.

11 55. APS shall adopt the practice of using "blind" procurement techniques, such as
12 electronic auctions, electronic trading platforms or independent brokers, for all its short term
13 purchases with the exception of emergency purchases. APS shall file a draft protocol adopting this
14 practice, for Commission approval, by March 30, 2003.

15 56. While we adopt the guidelines set forth in Findings of Fact Nos. 51-55 above, they do
16 not constitute an all-inclusive list of the restrictions on the type of activities that APS and its affiliates
17 must prevent. We want to make clear that any preferential or discriminatory activity by APS, its
18 parent or affiliates that interferes with a fair, unbiased solicitation process, whether specifically
19 delineated or not in the standards of conduct, the Code of Conduct, or this Decision, will not be
20 tolerated, and that we will closely scrutinize the solicitation process for signs of any such abuse.
21 Notwithstanding any other provision of this Opinion and Order to the contrary, nothing herein shall
22 be construed as prohibiting APS, Pinnacle West, or PWEC officers and directors from providing
23 corporate oversight, support and governance to their employees so long as such activities do not favor
24 PWEC in Track B or provide PWEC with confidential bidding information during the Track B
25 procurement that is not available to all other Track B bidders; nor prohibiting APS or Pinnacle West
26 employees from communicating with PWEC employees about non-Track B matters.

27 57. TEP buys power on the wholesale market, but currently has no affiliate offering power
28 on the wholesale market.

1 58. TEP requested that the Commission waive the applicability of Section IV.C, paragraph
2 1, lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing
3 department to be involved in the initial solicitation process.

4 59. Because TEP does not have an affiliate that will bid in the upcoming initial
5 competitive solicitation process, we find that it is reasonable to, and shall, grant TEP's request to
6 allow TEP's Wholesale Marketing department to be involved in this initial solicitation process.

7 60. In the event a TEP affiliate does plan to offer power on the wholesale market, TEP
8 shall adopt the practice of using "blind" procurement techniques, such as electronic auctions,
9 electronic trading platforms or independent brokers, for all its short term purchases with the
10 exception of emergency purchases. TEP shall file a draft protocol adopting this practice, for
11 Commission approval, 60 days prior to a TEP affiliate offering any power on the wholesale market.

12 61. Based on the record in this proceeding, it is not necessary at this time to require that
13 APS or TEP solicit DSM bids, but this finding does not prohibit the submission of such bids.

14 62. It is reasonable for the Commission to hold workshops to explore the development of
15 a DSM policy and an environmental risk management policy, with such exploration to include an
16 examination of the possible costs and benefits of the respective policies. We will therefore direct
17 Staff to facilitate a workshop process to explore the development of a DSM policy and an
18 environmental risk management policy, with such exploration to include an examination of the
19 possible costs and benefits of the respective policies, and to file a report, within 12 months from the
20 date of this Decision, informing the Commission of the progress achieved in the workshops,
21 including a Staff recommendation on whether hearings should be held as suggested in Exhibits DB-2
22 and DB-3 to Exh. LAW-1.

23 63. The Codes of Conduct have not yet been addressed in these dockets. We will
24 therefore direct Staff to file reports in these dockets, within 60 days from the date of the Independent
25 Monitor's final reports, on the Codes of Conduct previously filed by APS and TEP. The Staff
26 Reports should include, but not be limited to, an analysis of the standards of conduct developed in
27 this proceeding, their applicability to the respective Codes of Conduct filed by TEP and APS, and
28 recommendations regarding their incorporation into the Codes of Conduct. Hearings will be

1 scheduled on the Codes of Conduct following the filing of those Staff Reports.

2 64. The issue of the continuation of the AISA under the Commission's rules and the
3 Commission's decisions approving the APS and TEP Settlement Agreements should be further
4 examined. Staff is directed to file an update to its November 2001 Staff Report that considers the
5 Commission's recent decisions in these consolidated dockets and makes appropriate
6 recommendations in the AISA Docket No. E00000A-01-0630 on or before May 30, 2003. The
7 Hearing Division is directed to notice a proceeding in compliance with A.R.S. § 40-252, with notice
8 and an opportunity to be heard to the affected parties concerning the continuation of the AISA, as
9 timely as possible upon the filing of the updated Staff Report.

10 65. Expedited approval of procurement contracts entered as a result of the competitive
11 solicitation would pose a substantial risk to consumers and is not necessary at this time for the
12 protection of either the utilities or the merchants. The "Price to Beat" concept (page 24, line 24
13 through page 26, line 14 of the Staff Report attached hereto as Exhibit A) was abandoned at hearing
14 and the expedited approval of procurement contracts entered as a result of the competitive solicitation
15 is not necessary at this time for the protection of either the utilities or the merchants and neither is
16 adopted by the Commission.

17 66. The review processes set forth in the Staff Report at page 27, including the prudence
18 review, are reasonable. We will require that Staff file a report in these dockets by July 15, 2003, or
19 earlier, informing the Commission of its progress in the contemplated reviews described at page 27 of
20 the Staff Report.

21 67. Notwithstanding any other provisions of this Order, TEP and APS shall evaluate all
22 bids, including those that may cover hours of the year designated as RMR hours, to determine
23 whether or not they provide benefits to consumers.

24 68. The target dates enumerated in the Staff solicitation time line provided at page 29 of
25 the Staff Report may be adjusted by the utilities, after consultation with the Staff and the Independent
26 Monitor, to accommodate both the issuance of this Order and to provide more time for the concurrent
27 evaluation of bids, including those that do not conform to the RFPs issued by APS and TEP.
28 However, any contracts for service from this initial Track B solicitation shall be entered on or before

1 June 1, 2003.

2 **CONCLUSIONS OF LAW**

3 1. The Commission has jurisdiction over these proceedings.

4 2. Notice of these proceedings was given as required by law.

5 3. Pursuant to Article 15, § 3 of the Arizona Constitution, the Commission has full power
6 to make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and
7 safety, and the preservation of the health, of the employees and patrons of public service
8 corporations.

9 4. Pursuant to A.R.S. § 40-361, every public service corporation shall furnish and
10 maintain such service, equipment and facilities as will promote the safety, health, comfort and
11 convenience of its patrons, employees and the public, and as will be in all respects adequate,
12 efficient, and reasonable.

13 5. Pursuant to A.R.S. § 40-321 and 40-331, the Commission has broad authority to
14 regulate the service and facilities of public service corporations in order to protect the public.

15 6. It is reasonable and in the public interest to require that APS and TEP test the market
16 in this solicitation, beyond the required power that cannot be produced from their respective existing
17 assets or existing contracts, which will also allow APS and TEP to evaluate whether reliable
18 generation is available at a lower cost than that produced by their own existing assets, or at a
19 comparable level of cost.

20 7. It is reasonable and in the public interest to require APS to solicit for capacity and
21 energy in the amounts referenced in Findings of Fact Nos. 41 and 43 above.

22 8. It is reasonable and in the public interest to require TEP to solicit for capacity and
23 energy in the amounts referenced in Findings of Fact Nos. 42 and 44 above.

24 9. It is also reasonable and in the public interest to require APS and TEP to determine,
25 after serious economic and technical analysis, using least cost planning principles, whether bids
26 offered in the solicitation, including both long- and short-term bids, would serve their customers
27 more economically than their existing assets, and to make procurements accordingly, with the right to
28 reject all bids if necessary, keeping in mind that the goal of the competitive solicitation is to provide

1 ratepayers with reliable power at the lowest cost, while considering the air quality and water issues
 2 effects of their procurement decisions, as well as whether their decisions further the Commission's
 3 goal of encouraging the development of a robust competitive wholesale generation market.

4 10. Imposition of the conduct requirements set forth in Findings of Fact Nos. 51-56 and
 5 60 is reasonable and necessary in order to protect the integrity of the solicitation process and the
 6 public interest.

7 11. It is reasonable and in the public interest to allow TEP's Wholesale Marketing
 8 department to be involved in the initial solicitation process, as TEP has no affiliate offering power on
 9 the wholesale market at this time.

10 12. It is not in the public interest for the Commission to review the prudence of
 11 procurement contracts resulting from this solicitation on an expedited basis.

12 13. The record in this proceeding supports Commission adoption of the Detailed Staff
 13 Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report and
 14 attached hereto as Exhibit A, as modified by the discussions and Findings of Fact herein.

15 **ORDER**

16 IT IS THEREFORE ORDERED that the Detailed Staff Proposed Solicitation Process
 17 appearing at pages 6-27 of the October 25, 2002 Staff Report, and attached hereto as Exhibit A, is
 18 hereby adopted, as modified by the discussions and Findings of Fact herein, and APS, TEP and Staff
 19 shall comply with its requirements, as modified by the discussions and Findings of Fact herein.

20 IT IS FURTHER ORDERED that APS, TEP and Staff shall comply with the directives of the
 21 discussions and Findings of Fact herein.

22 IT IS FURTHER ORDERED that all bidders shall comply with the Detailed Staff Proposed
 23 Solicitation Process and permit plant inspections, and shall also provide written assurances that serve
 24 as guarantees against a bidder's engaging in unlawful market manipulation as discussed in this Order
 25 and Findings of Fact No. 26.

26 ...

27 ...

28 ...

1 IT IS FURTHER ORDERED that the Commission's actions in this proceeding do not
2 constitute state action for the purposes of antitrust laws. It is not our intent to insulate Arizona Public
3 Service Company, its parent, or affiliates, or Tucson Electric Power from any provisions of law that
4 prohibit the restraint of trade.

5 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
7
8

9 CHAIRMAN

COMMISSIONER

COMMISSIONER

10
11 COMMISSIONER

COMMISSIONER
12
13

14 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
15 Secretary of the Arizona Corporation Commission, have
16 hereunto set my hand and caused the official seal of the
Commission to be affixed at the Capitol, in the City of Phoenix,
this ____ day of _____, 2003.

17
18 _____
BRIAN C. McNEIL
EXECUTIVE SECRETARY

19
20 DISSENT _____

21 DISSENT _____
TW:dap
22
23
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25
26
27
28

SERVICE LIST FOR:

GENERIC PROCEEDINGS, ARIZONA PUBLIC
SERVICE COMPANY and TUCSON ELECTRIC
POWER COMPANY

DOCKET NOS.:

E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-
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EXHIBIT A

D. Detailed Staff Proposed Solicitation Process**I. Scope Of 2003 Solicitation**

For 2003, the solicitation will be for all load and energy requirements not served by generation owned by the utility and included in the utility's rate base as of September 1, 2002, except to the extent that such generation is providing RMR service during RMR hours or by power supplied pursuant to FERC or Commission approved contracts with affiliated and non-affiliated suppliers entered into prior to September 1, 2002. To the extent that affiliated suppliers provide service pursuant to contracts dated on or after September 1, 2002, such service will be subject to competitive solicitation except to the extent that such contract is to provide RMR service during RMR hours. To the extent that load is served pursuant to capacity or energy contracts with Qualifying Facilities or Environmental Portfolio Standard requirements that load will also not be contestable. Any generation capacity owned by a utility that has not been included in the utility's rate base may be bid by the utility in the initial solicitation on the same terms and conditions as all other bidders, including affiliated bidders. All demand-side management commitments in place as of September 1, 2002, shall be considered in determining contestable load.

For solicitations during 2003, each utility may contract for energy and capacity deliveries for differing time periods in order to test the efficiency of this process for acquiring short-term, medium-term and long-term contracts. While it is anticipated that during 2003 each utility will primarily require peaking capacity and energy with contract terms of one to three years, if, in the judgment of the utility, market conditions or economic opportunities dictate contract terms longer than three years, it will be the responsibility of the utility to enter into such contracts as are reasonable. For resource planning purposes each utility must demonstrate that its power supply portfolio contract durations are adequately diversified and that its portfolio's structure mitigates both cost and reliability risks appropriately.

Based on information available at this time, contestable loads for each utility for each year through 2006 are estimated to be:

CAPACITY (MW)

	2003	2004	2005	2006
APS ¹	1951	2289	2628	2898
TEP ²	242	309	441	488

ENERGY (MWH)

	2003	2004	2005	2006
APS ³	6,566,910	7,704,591	8,845,638	9,754,436
TEP ⁴	345,300	345,460	388,460	389,460

The above capacity numbers for APS were provided by APS at the August workshop and were used by Staff to derive the energy numbers. Staff was subsequently informed by APS that the numbers provided at the August workshop required revision. In response to a data request from Staff, APS provided revised capacity and energy numbers on October 23, 2002. Staff has not had time to review and analyze these numbers for inclusion in the Staff report by the October 25, 2002 publication date. APS' response to Staff's data request is included in this report as Appendix Two.

II. Roles & Responsibilities

A. Utility

¹ Source: From data provided by APS at the August Workshop.

² Source: From data provided by TEP at the August Workshop, plus 95 MW of combustion turbines that are not presently in rate base.

³ Assumes 38.6% average annual load factor for all contestable capacity.

⁴ From August data provided by TEP plus 95 MW combustion turbines at 40% average annual load factor.

1 Absent evidence of abuse, the utility will be responsible for preparing the solicitation and
2 conducting the solicitation process. Acquisition of energy and capacity to meet the needs of
3 customers remains the responsibility of the utility, and the utility shall use accepted business
4 standards for acquiring these resources, as it does when it buys all other products used in
5 providing service.

6 **B. Bidders**

7
8 In order for the Solicitation to attract wide participation, the process must be accepted as
9 fair, open and transparent. To achieve this, prospective bidders, and interested persons who agree
10 to keep certain information confidential, will have the opportunity to review supporting data and
11 draft documents in advance of the solicitation being distributed to bidders. All bidders and other
12 interested persons may provide comments to the utility, the Independent Monitor or the Staff
13 regarding the completeness or quality of the information provided. Bidders and interested parties
14 may also provide comments to the utility, the Independent Monitor or the Staff regarding the
15 process being employed or the decisions made regarding execution of the solicitation process.

16 All bidders will be required to consent to use appropriate alternative dispute resolution
17 practices, specified by the utility and fully disclosed in the Solicitation materials if a dispute
18 arises.

19 Each bidder must agree to permit the Commission Staff to inspect any generating facility
20 the bidder owns or controls from which it proposes to provide capacity or energy to any Arizona
21 utility pursuant to any contract awarded as a result of this solicitation.

22 **1. Access to data**

23
24 Bidders will have the opportunity to review non-restricted information used by the utility
25 in preparation for the solicitation, as well as draft solicitation materials, before the solicitation is
26 released. Bidders may provide comments to the Staff and the Independent Monitor regarding the
27 materials at any time before the bidders' conference.

2. Opportunities to contribute & review

One or more bidders' conferences will be held so that all interested parties will have the opportunity to ask questions directly of the utility as well as to identify any deficiencies in the solicitation documents or supporting data. The bidders' conference will be held at least 10 days before the release of the solicitation.

Each utility shall schedule at least one bidders' conference prior to the distribution of its solicitation materials in final form to answer questions and to receive comments and suggestions regarding the materials to be distributed from interested persons. The first bidders' conference must occur no later than February 15, 2003.

Bidders will be invited to review non-proprietary materials produced by the utility and to address comments or inquiries to the utility, Staff or the Independent Monitor regarding those materials at any time between the release of reports, plans or drafts and the conclusion of the bidders' conference.

C. Independent Monitor

1. Overview

To assist the Staff and to assure all parties to the Solicitation for power supplies that the process employed is conducted in a transparent, effective, efficient and equitable manner, an Independent Monitor will be appointed by the Staff of the Commission to oversee the conduct of the Solicitation. The Independent Monitor will be selected by the Staff and will work at the Staff's direction. Any person expecting to participate in the solicitation process may suggest to the Staff any individual to serve as the Independent Monitor. The utility will retain the Independent Monitor selected by the Staff and will be responsible for all related costs. The Independent Monitor shall submit all invoices to the Staff for review. The Staff shall forward the invoices to the utility with a recommendation as to payment.

1 The Independent Monitor will be responsible for:

- 2 • monitoring all communications regarding the solicitation by and among the utility
- 3 and any bidders or potential bidders;
- 4 • evaluating the adequacy, accuracy and completeness of all solicitation materials,
- 5 and the quality of the evaluations conducted;
- 6 • monitoring any negotiations conducted by the utility and any bidder;
- 7 • assisting the Staff in developing the "prices to beat" and such other tasks as
- 8 required;
- 9 • advising the Staff and the utility of any issue affecting the integrity of the
- 10 solicitation process and providing the utility an opportunity to remedy the defect
- 11 identified;
- 12 • periodically submitting status reports to the Commission and the Staff on the
- 13 solicitation being conducted, noting any deficiencies identified in the preparation
- 14 of solicitation materials, maintenance of records, communications with bidders, or
- 15 in evaluating or selecting bids;
- 16 • advising the Commission and the Staff of significant unresolved issues as they
- 17 arise;
- 18 • after bids have been selected, preparing and submitting a report to the Commission
- 19 detailing the Independent Monitor's observations and findings relating to the
- 20 conduct of the solicitation and any recommendations for improvements of the
- 21 solicitation process employed in the initial solicitation; and
- 22 • making all written status reports and the final reports to the Commission available
- 23 to any person having an interest in the solicitation.

24 The Independent Monitor shall have full access to all materials used in or relating to the
25 Solicitation. The utility shall make its personnel available for consultation with the Independent
26 Monitor as requested. The Independent Monitor shall attend, in person or telephonically, any
27 negotiations conducted with bidders.

1 Following the bidders conferences and before the distribution of the solicitation materials,
2 the Independent Monitor shall submit a status report to the Commission and the Staff noting any
3 unresolved issues that could impair the equity or appropriateness of the solicitation process.

4 **2. Post Selection Requirements**

5
6 Subsequent to the final bid selections and prior to announcing the selection of winning
7 bids, the utility shall meet with the Staff and the Independent Monitor to review its bid
8 evaluations and to explain the basis for its selections. Within 3 days of the selection of winning
9 bids, the Independent Monitor will file with the Commission a status report identifying the
10 winning bids and outlining any deficiencies noted in the solicitation process.

11 The Independent Monitor will also file with the Commission a report on the fairness and
12 effectiveness of the solicitation within 14 days of the selection of winning bids. In that report, the
13 Independent Monitor will describe the process employed and will evaluate the utilities'
14 conformity with the process requirements. If the Independent Monitor finds that the utility
15 unfairly or erroneously conducted the solicitation, the report should so state. If the Independent
16 Monitor believes that the selection process was flawed, the report submitted should detail the
17 Independent Monitor's basis for such belief.

18 **D. Staff**

19
20 Throughout the solicitation process, the Staff and Independent Monitor will review data,
21 review draft solicitation materials, and monitor the solicitation process. The Staff will observe
22 the solicitation process, but will not approve any action or certify any aspect of the solicitation
23 activities. If any disagreement concerning the solicitation occurs, the Staff or the Independent
24 Monitor will promptly notify the utility of its concern and discuss the matter with the utility.

25 The Staff, in conjunction with the Independent Monitor, will be responsible for reviewing
26 the resource plans, the price and cost forecasts, and the network transmission assessment to
27 encourage the utility to develop comprehensive supporting data, and advise the Commission
28 should the utility fail to address the information needs of the solicitation process. Also, the Staff

1 and the Independent Monitor will review forecast data provided by interested parties and compare
2 it to the forecasts provided by the utility when assessing the system needs.

3 **E. Commission**

4
5 The Commission may upon request of the Independent Monitor or at such time or times as
6 it deems appropriate, suspend or terminate the Solicitation in order to remedy any defect in the
7 solicitation process identified by the Independent Monitor. The Commission may order the utility
8 conducting the Solicitation to make changes to the solicitation process it deems necessary to
9 promote effectiveness, reasonableness, and fairness.

10 In the event that the Independent Monitor finds that the utility failed to conduct the
11 solicitation in an equitable manner, the Commission, after notice and hearing, may, among other
12 things, disallow the recovery of costs of power incurred pursuant to contracts entered as a result
13 of this Solicitation as well as the costs of conducting the solicitation or bar any bidder inequitably
14 awarded a contract as a result of the solicitation from bidding in any subsequent solicitation. If
15 the Commission finds that the utility failed to conduct an appropriate solicitation, it may order
16 that a new solicitation, conducted by an independent party, be commenced forthwith.

17 **III. Pre-Solicitation**

18 19 **A. Overview of process**

20
21 In order to be ready to conduct a solicitation by March 1, 2003, as required by the Track A
22 order, the utility must assemble information supporting the determination of products to be
23 solicited and the amount of each product that is needed. The utility must be prepared to evaluate,
24 without delay, all offers presented, including offers to deliver power to points that may differ
25 from the utility's requested points of interconnection. The required data typically collected in the
26 ordinary course of business will serve as the basis for all information to be provided to the Staff,
27 Independent Monitor and bidders, though some will need to be modified to be suitable for the

1 solicitation. To facilitate a timely solicitation, the utility should begin assembling the necessary
2 information without delay.

3 **B. Data Collection**

4
5 Prior to preparation of solicitation materials, supporting data shall be assembled by the
6 utility and provided to the Staff and the Independent Monitor for their review at the earliest date
7 practicable. These data shall include resource plans, load, price, and cost forecasts, and a network
8 transmission assessment containing such information and in formats acceptable to the Staff,
9 designed to facilitate the solicitation process. Once the Staff and the Independent Monitor have
10 completed their review, the following data shall be made available to bidders expressing intent to
11 bid and who have signed a confidentiality agreement: load forecasts, resource plans, needs
12 assessments, and transmission assessments, as appropriate. Price and cost forecasts for power
13 supplies and fuel costs prepared by, or available to the utility, will not be made available to
14 bidders. Bidders may provide comments to the Staff or Independent Monitor on the quality or
15 completeness of any information provided at any time.

16 In preparation for the solicitation, each utility shall prepare a list of potential bidders to
17 whom bid materials will be sent. That list should be as expansive as is reasonable. Once
18 assembled, that list is to be provided to the Staff and the Independent Monitor and posted on the
19 solicitation website. Identified potential bidders are to be contacted and invited to submit a letter
20 of intent to bid. Prospective bidders not identified by the utility will be added to the bidders list
21 by submitting a letter of intent to bid.

22 **C. Resource Plans**

23
24 Prior to the first solicitation, each utility that will solicit power during 2003 must provide
25 to the Staff and the Independent Monitor its current 10-year load and energy forecast and resource
26 plan. Utility personnel must be made available to discuss the load forecast and resource plans
27 with the Staff and the Independent Monitor.

1 The Resource Plan must describe all power sources currently employed to meet load
2 including: generation owned by the utility, existing power supply contracts with affiliated and
3 non-affiliated utilities, planned additions and retirements, contract expirations, loads to be met
4 through the use of demand side management and contracts to satisfy the Environmental Portfolio
5 Standard. The Resource Plan should identify RMR plants, the hours during which such plants are
6 RMR, and the criteria employed to determine RMR. Additionally, the Resource Plan should
7 detail the utility's planned outage schedule and any planned unavailability of power from contract
8 suppliers. Planned reserve requirements shall also be specifically identified.

9 The utility will review with the Staff and the Independent Monitor the adequacy of
10 resources committed to serve expected loads and the reliability of the resources planned to serve
11 that load.

12 Based on the utility's load and energy forecast and the resource plan, the utility will
13 develop a needs assessment. The needs assessment will be designed to identify specific capacity
14 and energy needs and such other services and/or facilities as may be needed over the term of the
15 load forecast.

16 The load forecast, resource plan and needs assessment will be reviewed with the Staff and
17 the Independent Monitor.

18 **D. Price & Cost Forecasts**

19
20 Each utility will provide to the Staff and the Independent Monitor its four-year forecast of
21 its power supply costs from its existing power sources.

22 Each utility shall provide to the Staff and the Independent Monitor the forecast of fuel
23 prices that the utility used in preparation of its power supply costs and all other fuel forecasts
24 relied on, or reviewed by, the utility.

25 Additionally, each utility shall provide to the Staff and the Independent Monitor a four-
26 year forecast of the prices of wholesale power products, including both capacity and energy
27 products by season and time period, in Western wholesale markets for delivery in Arizona
28 prepared by an independent source that makes such estimates available in the normal course of its

1 business. Each utility shall also provide to the Staff and the Independent Monitor copies of all
2 other forecasts of the prices of wholesale power supplies in Western wholesale markets for
3 delivery in Arizona in the possession of or reviewed by the utility. The utility shall identify the
4 source of each such forecast, and explain the strengths and weaknesses of each of the forecasts
5 supplied.

6 Potential bidders may also submit wholesale price forecasts to the Staff. Those forecasts
7 must clearly identify the source of the forecast and all assumptions relied on in preparing the
8 forecast.

9 All forecasts provided will remain confidential and will serve as the basis for certain
10 evaluative and review purposes as are discussed later in this document. During the reviews
11 described above, the Staff and the Independent Monitor will examine the assumptions relied on in
12 making the forecasts and assessments presented.

13 E. Deliverability Qualifications

14

15 The utility must provide Staff and the Independent Monitor with a listing of each
16 committed use of its transmission capacity for the period over which resources are to be solicited.

17 The utility will perform and submit for review by the Staff and the Independent Monitor a
18 network transmission assessment of the maximum resource capacity that can be physically and
19 reliably accommodated simultaneously at all technologically feasible interconnection and delivery
20 points. Such transmission limitations are to be used as a guide in the evaluation of deliverability
21 of specific combinations of bid resource capacity and energy.

22 Upon completion of this review, the utility will be responsible for preparing and
23 conducting a solicitation that encourages multiple bidders to respond to the solicitation. The
24 specifics of products to be solicited, contract terms and conditions, terms of the confidentiality
25 agreement, and the specific solicitation mechanics to be employed will be at the discretion of the
26 utility. In any event, the process must be designed to promote acquisition of reliable power at
27 reasonable costs over the long term.

1 **F. Identification of Products**

2
3 Each utility shall determine the specific products it will contract for in order to maintain
4 an appropriately structured power supply portfolio. For 2003, utilities may request bids for firm
5 power (e.g. on-peak and off-peak, annual or seasonal, capacity and energy blocks), and unit
6 contingent supplies, as appropriate. Additionally, to the extent required, solicitations for ancillary
7 services including, but not limited to, load following or spinning reserves, may be undertaken. It
8 is, anticipated that bidders will provide all ancillary services required to support their bids. If the
9 utility provides ancillary services to any generating asset not in its rate base, the utility shall make
10 those ancillary services available to all bidders on the same terms and at the same price as
11 available to those assets.

12 In identifying the products to be contracted for, the utility will specifically define the
13 capacity and energy sought on a time-differentiated basis and the periods for which services will
14 be purchased. The solicitation materials will contain the terms and conditions proposed by the
15 utility, including the right of the utility to reject all bids and to amend the request for service
16 without notice. The solicitation materials shall include a model contract.

17 **IV. Preparation Of Initial Solicitation**

18
19 **A. Overview**

20
21 The materials to be provided to potential bidders shall be prepared by the utility and shall
22 be developed in a manner that facilitates the preparation of responsive and competitive bids. The
23 materials must be accurate and sufficiently detailed so that no bidder is afforded an undue
24 advantage. The terms and conditions must be reasonable and commercially acceptable and must
25 be reviewed by the Independent Monitor and the Staff.

1 **B. Solicitation Material Content**

2
3 The utility will have responsibility for preparing all solicitation materials. The materials
4 will be prepared in a timely manner so that the Staff and the Independent Monitor will have time
5 to review the documents and suggest changes, before they are provided to interested parties for
6 comment.

7 The utility will prepare bid packages that contain a description of the specific products to
8 be acquired, the capacity and energy to be acquired, the bidding method to be employed (e.g.
9 Request for Proposal or Descending Clock Auction), a copy of the contract to be executed, the
10 preferred delivery points, the evaluation criteria to be used, bid fees (if any), credit requirements,
11 due dates and such other information as may be appropriate.

12 It will be the responsibility of the utility to prepare draft solicitation materials and to discuss
13 these drafts with the Staff and the Independent Monitor prior to distributing them in draft form to
14 potential bidders. These drafts will include but will not be limited to: the specific power supply
15 products sought, points of delivery, a model contract and confidentiality agreement, the bid
16 requirements, pre-qualification requirements, creditworthiness requirements, the solicitation
17 method to be employed, information describing the utility and its forecast load, and the evaluation
18 criteria to be used.

19 In the Solicitation materials the utility will describe in detail how it will conduct bidding,
20 such as how many rounds of bids will be accepted, Descending Clock Auction procedures, etc.
21 The utility may specify that bids must be firm and for how long bids must be open after the
22 auction is completed. If a Request for Proposal is used, a utility may specify that bids must be
23 valid for up to 30 days.

24 Price caps or auction reserve prices may be established by the utility. Any caps or auction
25 reserve prices established must be disclosed to and discussed with the Staff and the Independent
26 Monitor before the solicitation occurs. No limitations are to be placed on the maximum or
27 minimum capacity or energy that any bidder may bid for or provide.

1 The solicitation materials will also describe the criteria to be used to select winning bids
2 and the weighting, if any, to be placed on each criterion.

3 The following criteria may be used to evaluate bids:

- 4 - Delivered price
- 5 - Deliverability
- 6 - Reliability
- 7 - Creditworthiness
- 8 - The source(s) of power for unit contingent products
- 9 - System benefits
- 10 - Exceptions to bid specifications and/or model contract terms and
- 11 conditions
- 12 - Other criteria as appropriate and made publicly available

13 The bid package prepared by the utility should specify preferred delivery points and, if
14 available, equivalent delivery points and any incremental costs the utility will incur if bidders
15 deliver to those equivalent delivery points. The utility shall disclose to the bidders the existence of
16 the network transmission assessment previously provided to the Staff and the Independent
17 Monitor, and disclose that the assessment will be used in evaluating equivalent delivery points.
18 The solicitation materials will specify the process the utility will use to identify whether any
19 constraints would be created on its system as a result of deliveries to any alternative delivery
20 point, how it will estimate the cost and time required to relieve the constraint, and the costs a
21 bidder will incur to mitigate the constraint.

22 The bid materials will also describe the Supplier information to be provided and the dates
23 when such information is due. This requirement may include a demonstration of the bidder's
24 experience in providing services and evidence of the bidder's creditworthiness. Utilities shall
25 require bidders to provide a description of the sources of electricity they intend to use to supply
26 service.

27 The bid materials will specifically describe the credit support acceptable to the utility both
28 as to form and amount. However, bidders may provide alternative credit support arrangements

1 and, if equivalent to that specified, the utility must evaluate the proposal as it would a conforming
2 bid. Equivalent credit support arrangements may include, but will not be limited to, appropriate
3 parental or affiliate guarantees.

4 Bid materials will also include:

- 5 - A draft Confidentiality Agreement
- 6 - Identification of any pre-qualification requirements
- 7 - Identification of any bid fees

8 **C. Communications**

9

10 Only those employees, officers, directors or contractors of the utility or its affiliates
11 specifically assigned by January 1, 2003, to prepare the solicitation materials or to evaluate bids
12 received, may participate in the preparation of solicitation materials or evaluation of bids. All
13 persons assigned to the solicitation by the utility shall be subject to a standard of conduct
14 established for the purpose of maintaining a separation between the utility and any affiliated
15 entity or person. Persons who work for an affiliate, parent, or part of the utility involved in the
16 sale or marketing of resources from generating assets owned by the utility shall not participate in
17 the solicitation preparation or evaluation of bids, or have any contact regarding the solicitation
18 with any personnel assigned to conduct the solicitation, except on the same terms as any other
19 bidder.

20 A protocol shall be established for all communications between the utility and all
21 prospective bidders, regardless of whether they are affiliates or third party bidders. The protocol
22 must prohibit the dissemination of any data to an affiliated person that are not provided to all
23 other interested persons on equal terms and at the same time. The utility will identify to the Staff
24 and the Independent Monitor, the information it proposes to restrict access to by bidders and other
25 interested persons.

26 The Staff and the Independent Monitor will review all draft solicitation materials before
27 they are released to the parties for their review.

1 Concurrently, the utility will establish the procedures it will employ to communicate with
2 all potential bidders. That communications plan must be designed to maintain confidentiality and
3 to provide equal access to information to all. All bidders, including utility affiliates, must be
4 required to communicate with the utility on equal terms. The approach adopted must be shown to
5 provide no undue advantage to any potential bidder.

6 By January 1, 2003, each utility shall establish and maintain a solicitation website as the
7 medium for communicating with bidders prior to the bid date, except for confidential exchanges
8 regarding pre-qualification and creditworthiness. Bidders will address all inquiries to the utility
9 on the website. Each inquiry and the utility response thereto shall be posted so that all bidders
10 have equal access to information. The website will also be used to provide timely access to data
11 and other information, such as the bidders list and the form letter of intent to bid that bidders may
12 use to be placed on the bidders list.

13 Pre-solicitation data shall be posted on the website as soon as it has been reviewed by
14 Staff and the Independent Monitor but in no case less than 5 days before the last bidders'
15 conference.

16 Bidder inquiries to the Independent Monitor may also be addressed using the solicitation
17 website. All bidder inquiries to the Independent Monitor and the response provided, regardless of
18 how the inquiry is made, will be posted on the solicitation website for review by all bidders.

19 As part of the communications protocols established by the utility, each utility shall
20 establish a system for logging all contacts between utility personnel and bidders and potential
21 bidders. That protocol must, at a minimum, require recording the date and time of any
22 conversation, whether telephonic or in person, the substance of that discussion and whether the
23 Independent Monitor participated in the contact. The utility shall maintain copies of all e-mails
24 exchanged between the utility and bidders or potential bidders, copies of all correspondence, and
25 all such other communications as may occur regarding the solicitation, for the terms set forth
26 below.

27 Each utility shall schedule one or more bidders' conferences to answer questions posed by
28 potential bidders and to take comments regarding the adequacy and quality of the information

1 provided to bidders. All bidders' conferences must be completed at least 10 days before the
2 release of the final bid package.

3 Based on the comments received, the utility, after consultation with the Staff and the
4 Independent Monitor, shall make such changes, as it deems necessary and produce in final form
5 its solicitation materials.

6 **D. Pre-qualification**

7
8 Participation in pre-qualification shall be a prerequisite to having a bid accepted. The
9 utility shall begin pre-qualifying bidders at the same time it assembles the list of prospective
10 bidders. As bidders indicate their intent to submit a bid, the utility shall provide all necessary
11 documents to complete the pre-qualification and undertake the review of completed bidder
12 submissions as they are received.

13 Bidders shall be pre-qualified for:

- 14 • Creditworthiness
15 • Deliverability
16 • Reliability
17 • Business reputation and experience

18
19 The utility shall notify bidders of their pre-qualification status no less than 14 days before
20 bids are due. Any bidder that has not successfully pre-qualified by that date shall be afforded the
21 opportunity to submit pre-qualification materials or to cure any failure to pre-qualify before the
22 bid date.

23 The specific pre-qualification requirements are dependent on the products to be contracted
24 for and will be established by the utility. Standards for pre-qualification, including minimum
25 credit worthiness, shall be included in the solicitation materials. Information provided by bidders
26 as part of the pre-qualification process is to be considered confidential.

1 **E. Solicitation Cost**

2
3 The cost of conducting each solicitation is a business expense to be borne by all bidders in
4 a fair and equitable manner. To that end, bid fees of up to \$10,000 per bidder will be permissible.
5 To the extent that bid fees collected exceed the incremental expenses incurred by the utility to
6 conduct the solicitation, such excess is to be refunded to all non-winning bidders pro rata up to
7 the amount of the bid fee actually paid by the bidder. Any costs incurred by the utility in excess
8 of bid fees collected may be considered in subsequent regulatory proceedings.

9 Any utility requiring the payment of bid fees will be responsible for their collection and, if
10 required, the refund of any amounts collected in excess of the costs incurred in conducting the
11 solicitation.

12 Once a solicitation is provided to potential bidders, the utility will employ the steps laid
13 out in the following section (V. Conducting the Solicitation) for each type of solicitation.

14 **V. Conducting The Solicitation**

15
16 **A. Overview**

17
18 In conducting the solicitation, whether by Request for Proposal or Descending Clock
19 Auction, the utility shall employ standard sets of requirements and evaluative tools, appropriate to
20 the type of solicitation conducted.

21 Bid evaluation will be conducted by a team of personnel including representatives of the
22 utility and the Independent Monitor. In evaluating bids, the utility shall use a standard set of
23 evaluative criteria, including a single fuel forecast for each type of fuel. The utility will also
24 determine creditworthiness and deliverability using criteria that are unbiased and allow differing
25 means of providing risk mitigation. Final bid selections will be at the sole discretion of the utility.

26 During the solicitation process, the Independent Monitor will oversee the solicitation
27 process to ensure compliance with process requirements and to assure that evaluations are

1 conducted in an unbiased fashion. The Staff may be present during bid evaluations and may
2 observe the solicitation process at its discretion.

3 **B. Bid Evaluation**

4
5 Bid evaluations should be conducted in three phases. The first should be to rank order the
6 bids by price using valuation methods that equalize volumetric and or duration differences on a
7 price basis. In the case of a Descending Clock Auction for firm power at fixed prices, only pre-
8 qualified bids will be rank ordered. In the case of unit contingent Requests for Proposals or for
9 non-conforming offers, approaches to valuing the bids that determine an equivalent per MWh net
10 present value of the cost of the bid to the utility by using approved annuity-based approaches may
11 be employed.

12 Phase Two should, to the extent not determined during pre-qualification, evaluate
13 deliverability using the network transmission assessment previously provided to the Staff and the
14 Independent Monitor. To the extent practicable, network resource status should be assigned to
15 appropriate bids. Network service is to be provided pursuant to each utility's OATT. Bidders
16 may propose delivery to alternative points (i.e. points other than those specified). In such case,
17 the utility shall determine the deliverability of the capacity and energy bid using its best efforts.
18 If a bid imposes delivery costs on the utility, the bid price as evaluated should be adjusted to
19 reflect those costs and a new rank order established. If the bidder is prepared to mitigate those
20 costs at its expense, no such adjustment need be made. All assessments of alternative delivery
21 points shall be provided to the Staff and the Independent Monitor prior to the selection of winning
22 bids.

23 During Phase Three all other factors not previously considered are to be evaluated. These
24 include evaluations of creditworthiness, experience and proposed exceptions to model contract
25 terms and/or conditions.

26 To the extent necessary, the utility may conduct post bid negotiations with selected
27 bidders to clarify bid terms or to resolve issues relating to exceptions noted in submitted bids.
28 Additionally, the utility may conduct final negotiations with selected bidders to resolve any other

1 issues that may arise. All such meetings are to be attended, in person or telephonically, by the
 2 Independent Monitor to assure that no undue advantage is afforded any bidder. Based on the
 3 evaluations conducted, the utility will, after consultation with the Independent Monitor, and
 4 discussion with Staff, select the winning bids.

5 **C. Request for Proposal Bid Evaluation Procedures**

6
 7 Bids in response to a Request for Proposal are confidential and are to be submitted in
 8 sealed envelopes to be opened simultaneously at the Commission in the presence of the utility's
 9 bid evaluators, assigned Staff personnel, and the Independent Monitor. RUCO may also attend.
 10 Bids submitted may not be withdrawn for up to 30 days or until rejected by the utility.

11 Bid evaluation will be conducted by a team of personnel including representatives of the
 12 utility and the Independent Monitor. During the evaluations, the Staff may be present. Final bid
 13 selections will be at the sole discretion of the utility.

14 If the utility determines that all bids submitted are to be rejected, it will notify all bidders
 15 of its decision to reject all bids within 21 days of the day bids were opened.

16 **D. Descending Clock Auctions Bid Evaluation Procedures**

17
 18 All bids are confidential and must be firm until the auction has been completed.
 19 Electronically submitted bids must be secured and may not be reviewed except in the presence of
 20 the Independent Monitor. If feasible, bids will be reviewed at the offices of the Commission.
 21 The Staff and RUCO may also attend. However, no person selling or which may sell energy in
 22 competitive markets may review the bids (except of course for utility personnel assigned to the
 23 solicitation.)

24 **E. Terms Required for Staff Recommendation**

25
 26 Based on the utility's forecasts of its power supply cost, the submitted forecast of
 27 wholesale power supply in Arizona, and such other information as it deems appropriate, the Staff,
 28 assisted by the Independent Monitor, shall establish "prices to beat" for each product solicited for

each utility. The "prices to beat" established by the Staff will be used for the purpose of determining whether the Staff will recommend without further analysis a finding that prices contained in any contract meeting the conditions outlined below are reasonable. For contracts not meeting the "prices to beat" conditions outlined below, the Staff will, after further analysis, make findings and recommendations relating to prudence, reasonableness and used and usefulness as appropriate in any subsequent proceedings as scheduled by the Commission.

In any subsequent proceedings to recover the cost of power purchased pursuant to contracts entered as a result of the initial solicitation, the Staff will, without further analysis, recommend the Commission find the prices contained in such contracts are reasonable if the Monitor determines the solicitation was conducted appropriately and the following conditions are met:

- For contracts with durations of three years or less, the Staff will recommend without further analysis approving contract prices when such prices in each year of the contract are less than the "prices to beat" established by the Staff and permit, at the utility's sole discretion, extension of the contract for the same number of years at comparable prices and on the same terms.
- For contracts with durations longer than three years but less than eight years, the Staff will recommend without further analysis that the Commission find the prices contained in any contract reasonable when, in each year of the contract delivery period, prices for power are less than the "prices to beat" established by the Staff pursuant to the following schedule:
 - Contracts of 4 years if contract prices are less than the "prices to beat" by 4% or more during each year
 - Contracts of 5 or 6 years if contract prices are less than the "prices to beat" by 6% or more during each year

- Contracts of 7 years if contract prices are less than the "prices to beat" by 10% or more during each year.

- For contracts not meeting the conditions outlined above, the Staff reserves the right to challenge the prudence, reasonableness or usefulness of the contract entered.

The above-described recommendations by the Staff do not constitute a finding by the Staff that any contract was prudent or that the utility's power supply portfolio was prudently structured. The Staff reserves the right to contest the reasonableness of any recommended contract on its non-price terms or the utility's portfolio in its entirety in any future proceeding. Additionally, contracts not meeting the above stated standards will not automatically be viewed by Staff as unreasonable or imprudent. The reasonableness and prudence of contracts not meeting the above criteria will need to be evaluated by Staff in subsequent proceedings.

The "prices to beat" set by the Staff will not be disclosed. After final bid selections are announced, the Staff will identify those winning bids that have met the conditions set forth above.

VI. Post Selection Requirements

Within 14 days of the selection of winning bids, the utility will submit to the Commission a detailed report on the process employed to conduct the solicitation and an explanation of the basis for selecting the winning bids. To the extent that confidential information is to be provided it should be noted.

Within 3 days of the selection of winning bids the Independent Monitor will submit a status report on the solicitation process employed by the utility to the Commission. Within 14 days of the completion of the solicitation, the Independent Monitor will submit to the Commission the report described in Section II C 2 above.

Each utility shall maintain a complete record of all materials developed for, generated during or used in conducting the solicitation for the life of the longest contract, plus 5 years. The retained records shall include, but not be limited to, reports, internal and external communications, analyses, contracts, forecasts, bids submitted, questions received from bidders

1 and the answers provided in response, and resource plans. These materials will be available to the
2 Staff. To the extent that the material is not subject to a confidentiality agreement, these materials
3 will be available to the bidders upon reasonable terms and conditions.

4 Sometime after the completion of each utility's initial solicitation, the Commission Staff
5 will commence a review of the utility's power supply portfolio to examine the prudence of that
6 utility's planning and procurement practices, and to determine the effectiveness and efficiency of
7 the solicitation process employed.

8 Also, sometime after the completion of the initial solicitation, the Commission Staff will
9 commence a proceeding to review the solicitation process described in this document and will
10 recommend such changes to the process as may be appropriate. Any refinements will be intended
11 to improve the process and to enhance the development of a robust wholesale energy market in
12 Arizona. Additionally, that proceeding will address the planning for future solicitations at such
13 time and for such amounts of capacity and energy as may be needed.

14 **E. Solicitation Timelines**

15
16 On the following pages we have presented Solicitation Timelines for the two primary
17 solicitation methodologies discussed at the workshops: The Descending Clock Auction (as
18 proposed by APS in its initial comments on Track B Issues) and a more traditional Request for
19 Proposals approach to power supply acquisitions. The timelines illustrate the time periods during
20 which various required tasks are expected to be completed in order to assure that adequate power
21 supplies are available by July 1, 2003.

22 The timelines were reviewed with the workshop participants and there was a general
23 consensus that they captured the major tasks that will need to be undertaken and that in the
24 aggregate the tasks could be completed within the allotted timeframes.

**STAFF REVISED CONTESTABLE LOADS ESTIMATE
GENERIC ELECTRIC RESTRUCTURING - TRACK B
DOCKET NO. E-00000A-02-0051, ET AL**

CAPACITY (MW)

YEAR	2003	2004	2005	2006
Net Unmet Reliability Needs ¹	1661	1935	2055	2151
APS Phoenix Resources ²	660	660	660	660
APS Yuma Resources ³	139	139	139	139
APS	2460	2734	2854	2950
TEP Retail Load ⁴	1890	1956	1993	2030
-Transmission Import Limit ⁵	-1132	-1132	-1132	-1132
TEP	758	824	861	898

ENERGY (GWH)

YEAR	2003	2004	2005	2006
Net Unmet Reliability Needs ¹	639	840	1228	1469
APS Phoenix Supplied ²	37	90	165	263
APS Yuma Supplied	0	0	0	0
Economy Purchase ⁶	3705	4033	6695	6948
APS	4381	4963	8088	8680
Unmet Needs ⁷	50	46	120	104
Local RMR Generation Supplied ⁸	183	213	253	276
Economy Purchases ⁹	210	429	223	181
TEP	443	688	596	561

¹ Schedule PME-1, Peter M. Ewen, November 4, 2002 adjusted to include 15% reserves for all load.

² Work Papers, APS Metro Phoenix Reliability Must Run Estimates, Peter M. Ewen, November 4, 2002, page 76.

³ Schedule PME-9, Peter M. Ewen, November 4, 2002.

⁴ Exhibit 5, Track B Needs Assessment and Procurement Proposal, David Hutchins, November 4, 2002.

⁵ Ibid, existing capability with no local generation plus 182 MW for Saguaro to Tortolita 500 kV line #2 in 2003.

⁶ Schedule PME-13, Peter M. Ewen, November 4, 2002.

⁷ Exhibit 1, Track B Needs Assessment and Procurement Proposal, David Hutchins, November 4, 2002.

⁸ TEP Must-Run Summary (12/12) based on Nov. 2 Load Forecast.

⁹ TEP Purchase Power Summary (12/12) based on Nov. 2 Load Forecast.